# TESTIMONY OF
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# BEFORE THE UNITED STATES SENATE COMMITTEE ON BANKING, HOUSING, & URBAN AFFAIRS

# "FINANCIAL PRODUCTS FOR STUDENTS: ISSUES AND CHALLENGES"

**July 31, 2014**

Chairman Johnson, Ranking Member Crapo, and Members of the Committee, thank you for convening today's hearing on financial products for college students. The timing of this hearing could not be better. Families across the country are preparing to send students off to school over the next few weeks and, while most will have their financing squared away ahead of time, many will make important decisions about how and where to bank once they arrive on campus, therefore the need for safe, regulated, transparent products will never be more important.

The Consumer Bankers Association (CBA) is the trade association for today's leaders in retail banking—financial services geared toward consumers and small businesses. Our mission is to preserve and promote the retail banking industry as it strives to fulfill the financial needs of the American consumer and small businesses. CBA's corporate members (the nation's largest financial institutions, as well as many regional banks) collectively hold two-thirds of the industry's total assets. Our associate members represent the premier providers of technology and services to banks.

Several CBA members provide student loans and banking services for the 21 million students enrolled in U.S. colleges, as well as their families. [1] We appreciate the opportunity to offer the insights of our consumer-focused banks on these products, services, and their associated marketplaces.

Before addressing the specific issues you asked me to discuss, I think it is critical to acknowledge the real crisis we face today – the rising cost of higher education. Since 1978, tuition and fees at institutions of higher education have grown at more than four times the rate of inflation and even twice the rate of healthcare costs.[2] If policymakers fail to find ways to make college more affordable, then we are simply addressing the symptoms of a much bigger

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[1] U.S. Department of Education, National Center for Education Statistics. (2013). Digest of Education Statistics, 2012 (NCES 2014-015), Chapter 3. http://nces.ed.gov/fastfacts/display.asp?id=98

[2] *Bloomberg*, "Cost of College Degree in US Soars 12-Fold," August 15, 2012. http://www.bloomberg.com/news/2012-08-15/cost-of-college-degree-in-u-s-soars-12-fold-chart-of-the-day.html

problem and allowing it to snowball, to the detriment of our nation's youngest citizens. CBA members strongly believe in the pursuit of higher education, a term which can mean anything from vocational training to graduate work, depending on the student's plans. Continued learning is absolutely critical for economic mobility and the success of our nation's economy. Despite the rising cost of a diploma, study upon study has shown the return on the college investment remains unparalleled.[3] CBA's members are committed to helping their customers invest in themselves, their families, and ultimately their futures.

Deciding where to attend and how to pay for college are among the most important financial decisions an individual will make. Financial institutions can play a role in this process by offering products to help finance college and by working with students and their families on planning for their futures. Before many students take their first college tour, their families have already benefited from a multitude of services provided by financial institutions as they manage their savings. Increasingly, families obtain important advice on paying for college tailored to their needs. We think it is never too early to begin this planning process. Financial institutions, particularly retail banks, want to help their customers with this pivotal opportunity, but the role of financial institutions in higher education lending today is quite limited. I would like to provide you an update on student lending by the private sector.

**Today, the federal government dominates the student-lending marketplace.**

The Department of Education (DOE) disburses roughly $100-110 billion per year through the federal Stafford and PLUS programs, 92 percent of student and parent loans,[4]compared to $6.5-

[3] New York Federal Reserve Board, Current Issues in Economics, "Do Benefits of Colleges Still Outweigh the Costs?" May 2014. http://www.ny.frb.org/research/current_issues/ci20-3.pdf
[4] College Board, Trends in Student Aid 2013. https://trends.collegeboard.org/student-aid/figures-tables/growth-federal-and-nonfederal-loans-over-time

7.5 billion dispersed by private lenders.[5] Of the more than $1 trillion in outstanding student loan debt, less than 8 percent are private loans. According to the data analysis firm MeasureOne, which surveyed the seven largest private student lenders accounting for 90-95 percent of the private loan market, only $90 billion of the $1.2 trillion in outstanding student loan debt consists of private loans.[6]

In the wake of the financial crisis, many private student lenders strengthened their underwriting standards, while others continued their long-standing practice of conservative underwriting, and the performance of private student loans has responded accordingly with delinquency and default rates dropping markedly. Private student loans carry no government guaranty, so if they are not repaid, the lender loses.

As Beth Akers of the Brookings Institute recently wrote, "[The evidence] does not indicate that aggressive regulation of the private lending industry is necessary. As discussed, financial institutions have little incentive to provide loans they do not expect the borrower to repay. In this sense, the industry is self-regulating by design." [7]

For a lender to offer a sound private loan product, as required by prudential regulators, applications must be put through a robust underwriting process, where a determination is made whether the potential borrower is likely to repay their loans. Lenders encourage the use of cosigners, who often have more extensive credit histories and better credit scores than students, in order to offer the lowest possible interest rates for consumers. Unlike with federal Direct Loans, origination fees are not charged.

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[5] Measure One, Private Student Loan Report 2013. http://www.measureone.com/reports

[6] Measure One, Private Student Loan Report 2013. http://www.measureone.com/reports

[7] Center for Higher Education Reform, "How Much Is Too Much: Evidence on Financial Well Being and Student Loan Debt," May 2014. http://www.aei.org/files/2014/05/14/-how-much-is-too-much_100837569045.pdf

Data compiled in the MeasureOne 2013 survey of private student lenders, and reflected once again in the second Report issued two days ago (July 29th), clearly demonstrates the value of sound underwriting that responsibly assesses a borrower's ability to repay – delinquencies and defaults are declining and are at the lowest level since the credit crisis. Continuing strong private loan performance shows:

- Early stage delinquencies (30 to 89 days past due) declined 17 percent from Q1 2013 to Q1 2014 from 3.59 percent to 2.97 percent.
- Serious delinquencies (90+ days past due) declined 13 percent from Q1 2013 to Q1 2014 from 2.92 percent to 2.55 percent.
- Charge off rates also declined to post credit-crisis lows with rates dropping from 3.5 percent in Q1 2013 to 3.16 percent in Q1 2014.

Nearly three out of four private student loans are in active repayment status, as opposed to deferment or forbearance, a high rate which again illustrates that private student loan borrowers are successfully managing their repayment obligations.

By way of comparison, the federal student loan program carries a three-year cohort default rate of more than 14 percent.[8] Further, much of the federal loan portfolio is not in an active repayment status. Of those loans in active repayment, multiple reports have estimated more than 40 percent will default or become at least 90 days delinquent.[9] This is in spite of generous income-based repayment plans. Data available from the Consumer Financial Protection Bureau (CFPB) and others shows the average balance of income-driven repayment plans stands at more than $45,000, with an average defaulted federal loan balance of $14,000.[10] This suggests

[8] US Department of Education, Office of Federal Student Aid, National Default Rate Briefings for FY 2011 2-Year Rates and FY 2010 3-Year Rates.
http://www.ifap.ed.gov/eannouncements/093013CDRNationalBriefings2YRand3YR.html

[9] Institute for Higher Education Policy, "Delinquency: The Untold Story of Student Loan Borrowing," March 2011.
http://www.ihep.org/assets/files/publications/a-f/delinquency-the_untold_story_final_march_2011.pdf

[10] Consumer Financial Protection Bureau Blog, "A Closer Look at the Trillion," April 2013.
http://www.consumerfinance.gov/blog/a-closer-look-at-the-trillion/

income based repayment plans are helping certain types of borrowers, but may not be a "silver bullet" in terms of eliminating all federal loan defaults.

**Though both federal and private student loans support the attainment of higher education, these products are quite different in structure and design.**

As has been well-chronicled, there are numerous repayment options on federal student loans, including monthly payment plans tied to income, as well as easily available deferments and forbearances for times of economic hardship. Repayment flexibility is particularly necessary on federal student loans because federal student loans lack a robust assessment of a borrower's ability to repay. As then-CFPB Associate Director Raj Date has said, "If you are going to lend money, you should probably care about getting paid back. And if you care about getting paid back, you should probably inquire about, and evaluate, a borrower's ability to pay you back."[11]

However, the unique nature of the federal student loan program means traditional measures of ability to repay may not be useful for a large portion of these programs. The federal loan programs are designed to foster access to higher education, and the loans are meant to be repaid with future earnings. Annual and cumulative loan limits are somewhat helpful in preventing undergraduate federal Stafford Loan borrowers from over-borrowing. However, the PLUS Loan Program for parents and graduate students is designed to supplement the federal Stafford Programs. These loans are available up to the full cost of attendance, including living expenses, and only include a high-level check for major adverse credit events – they do not include a prospective assessment of the borrower's ability to repay.

[11] Remarks of Raj Date, American Bankers Association Conference, Orlando, FL, June 2012. http://www.consumerfinance.gov/newsroom/remarks-by-raj-date-to-the-american-bankers-association-conference/

By contrast, private student lenders are required to provide comprehensive disclosures of terms, conditions, and full life-loan borrowing costs at multiple times throughout the origination process—i.e., at application, approval, and consummation – and to tell students and families about federal aid programs' terms as well.[12] Private education loans are critical to helping families fund the gap between other available financial aid and the total cost of attendance. Through multiple disclosures and ongoing communications, private education lenders assure students and families are well informed about the cost and terms of their loans.

Private lenders must carefully assess ability to repay, and usually cosigners are required or encouraged, because the borrower often lacks credit history. In addition, private student loans are school-certified to prevent students from over-borrowing. Though only self-certification from the borrower is required under law, 96 percent of today's private student loans are also school-certified to ensure students are not borrowing beyond their need.[13] The remaining four percent of private loans which are non-certified are loan refinancing for students no longer enrolled, or are designed specifically for professional school graduates no longer affiliated with their institution, such as loans for law graduates preparing for the bar exam or medical school graduates in a residency program.

More than simply recouping their funds on the loan, banks involved in private student lending have the added incentive to provide excellent service to student loan borrowers because they are prospective customers for future products and services they will need when they leave school. Banks seek to develop trust and loyalty by providing quality products and services.

The combination of current and future economic incentives results in good customer service for private student loans. Analyzing data from a recent report by the CFPB, only 0.03 percent of

[12] Federal Reserve Amendments to Regulation Z (Truth in Lending), July 30, 2009. http://www.federalreserve.gov/newsevents/press/bcreg/20090730a.htm

[13] Measure One, Private Student Loan Report 2013. http://www.measureone.com/reports

private student loans received a complaint from consumers.[14] CBA's members adhere to the "one complaint is too many" philosophy but this incredibly low complaint rate suggests a high degree of customer satisfaction.

**In spite of its relatively small size, the private student loan market continues to respond to consumer demand.**

Private student lenders continue to respond to the needs of their customers. Lenders now offer private student loans with both fixed and variable rates, and most carry no origination fees, unlike federal loans. Private lenders continue to meet current refinancing needs, while also increasing their refinance offerings to accommodate customer demand. As far as refinancing existing private student loans, lenders are equipped to handle current demand. Several CBA members have offered a refinance product for some time, and others are beginning to launch new programs or are developing them. We expect demand for private loan refinance products to continue to grow, but the largest potential win/win for consumers and financial institutions may lie in the private refinancing of federal student loans.

Ironically, the CFPB may significantly inhibit the development of products to refinance federal student loans due to uncertainty over how the Bureau and the courts are defining "UDAAP" (Unfair, Deceptive and Abusive Acts of Practices). Even though they may be able to provide a lower rate, most private lenders are reluctant to refinance federal loans until it is clear they will not be liable for a UDAAP violation, because the loans are not eligible for federal income based repayment programs. CBA urges the CFPB, with the support of Congress, to clarify financial institutions will not be penalized for offering their customers well-informed choices to refinance their federal student loans.

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[14] CFPB "Mid-year update on student loan complaints." April 2014. http://www.consumerfinance.gov/newsroom/cfpb-finds-private-student-loan-borrowers-face-auto-default-when-co-signer-dies-or-goes-bankrupt/

While 98 percent of private loans demonstrate ongoing successful repayment, banks remain committed to providing robust options to the very small subset of private loan customers experiencing sustained financial distress. For the most distressed borrowers, banks continue to work with the prudential regulators to develop short and long term loan modification programs to provide borrowers with more flexibility, particularly in the early stages of their career. Some banks already have launched loan modification programs, while others are piloting programs in advance of a broader roll-out. These programs are designed to address the unique nature of student loan borrowers within the confines of safety and soundness principles.

Two major options are available for families to "fill the gap" in paying for college: the Parent PLUS loan or a private education loan.

- Parent PLUS: The federal government disbursed $10 billion to parents of undergraduate students last year at a fixed rate of 6.41% with no ability-to-repay assessment, only a review of serious previous credit problems. The government is also currently charging origination fees of 4.288 percent on all PLUS loans, a fee that budget sequestration is increasing every year.[15] Parent PLUS loans have no debt-to-income ratio test and, because the parent is not the beneficiary of the education, the loan does not offer income based repayment. A private education lender would never make this type of loan.
- Private Education Loan: A private education loan protects families from over borrowing through sound underwriting, including a thorough review of ability to pay. Over 90 percent of undergraduate loans have cosigners—most of these loans are provided to the student, who benefits from the education, with a parent as a cosigner. Unlike the PLUS loan, parents who do not have the income to afford the debt are protected from

[15] US Department of Education, Office of Federal Student Aid: https://studentaid.ed.gov/announcements/sequestration

taking out a loan they cannot pay. This is the ultimate consumer protection—ensuring a family does not undertake an obligation they cannot afford.

The benefit of the cosigner for the student cannot be overstated. A cosigner not only lowers credit risk to the point where a young person can get a loan, but he or she also helps the borrower secure a lower rate, and establish credit.

**Banks take every possible step to ensure service members and veterans receive the benefits afford to them.**

CBA members place compliance with the Servicemembers Civil Relief Act (SCRA) as a top priority. The SCRA caps the interest rate on loans taken out before military service at 6 percent and provides for deferments and forbearances of payments and other benefits during the service period. It is much easier for our members to ensure SCRA compliance on their private student loans than on their remaining FFELP loans due to conflicting statutes and regulatory guidance from federal agencies. CBA and others involved in the student lending community have asked the DOE for new guidance, which we have been told to expect soon, to clarify the regulations and allow loan holders and servicers to streamline the process of providing SCRA benefits to their eligible customers. We look forward to its release so servicemembers can have maximum flexibility in obtaining the benefits they deserve.[16]

In addition to providing a small but critical component of the education funding process, financial institutions play an important role on campuses by offering banking services such as checking and savings accounts designed specifically to meet students' unique needs and help establish their credit history.

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[16] CBA/EFC/SLSA letter to Secretary Duncan on SCRA, May 2014. http://www.cbanet.org/documents/2014%20Comment%20Letters/2014-05-21%20CBA-SLSA-EFC%20Letter%20to%20Secretary%20Duncan.pdf

**Banks provide valuable financial services and products to millions of students.**

Some CBA members have entered into agreements with institutions of higher education to provide useful services, such as campus ID cards that can be linked, at the option of students, faculty, staff, and others associated with the university, to a standard deposit account. These financial institutions also provide important services, such as on campus financial literacy programs and assistance with financial aid systems to colleges and universities. According to a GAO report, "Most of the college card fees we reviewed generally were not higher, or in some cases were lower, than those associated with a selection of basic or student checking accounts at national banks. In particular, college card accounts generally did not have monthly maintenance fees, while the basic checking accounts we reviewed typically did." [17]

Recently, the DOE entered into a negotiated rulemaking with a variety of stakeholders, including students, school representatives, banks, credit unions, consumer groups, and others, on the topic of "cash management," which includes the disbursement of student aid refunds, federal aid in excess of what is needed to pay school charges. Despite significant progress among non-federal negotiators and the offering of good-faith proposals by the bank and credit union negotiators, consensus proved elusive. This leaves the Department unbound by any agreements worked out during the negotiations, and free to write whatever changes to the regulations it wishes to propose.

CBA shares the DOE's goal of promoting students' understanding and management of financial products while ensuring they have meaningful choices. However, we have serious concerns about and objections to the expansiveness of the draft regulation related to disbursement of federal student aid credit balances, particularly with regard to non-disbursement accounts (i.e. accounts opened outside of the Title IV credit balance disbursement process), as well as

[17] COLLEGE DEBIT CARDS: Actions Needed to Address ATM Access, Student Choice, and Transparency (February 2014). http://www.gao.gov/assets/670/660919.pdf

sponsored disbursement accounts. Similar apprehensions relating to the scope of the DOE's rulemaking have been expressed by members of both parties and houses of Congress.

With regards to non-disbursement accounts, though the language in the draft regulation presented by the DOE during the negotiated rulemaking is not clear, it would certainly classify as "sponsored accounts" any traditional bank deposit account linked to a "campus card," such as a college identification card, even though the depository institution offering the account does not facilitate the delivery of federal student aid credit balances for the school – which is the true subject of the rulemaking. In addition, the draft regulation could cover any deposit account that *could* receive federal student aid credit balance disbursements held by a financial institution that happens to have other types of arrangements with colleges or universities ("educational institutions"). As sponsored accounts, these accounts would be subject to various requirements and significant restrictions under the proposed regulation, impacting relationships that have nothing whatsoever to do with the disbursement of federal student aid credit balances.

While the DOE has authority to write rules concerning Title IV financial aid disbursement and the methods under which disbursements are made, the proposed rule would go beyond that scope and regulate the availability and terms of deposit accounts, including debit cards and prepaid cards, available to students from depository institutions – separate and apart from the financial aid disbursement process. We can identify no authority for DOE's overreach to regulate deposit accounts that have, at best, only a tangential relationship with those accounts.

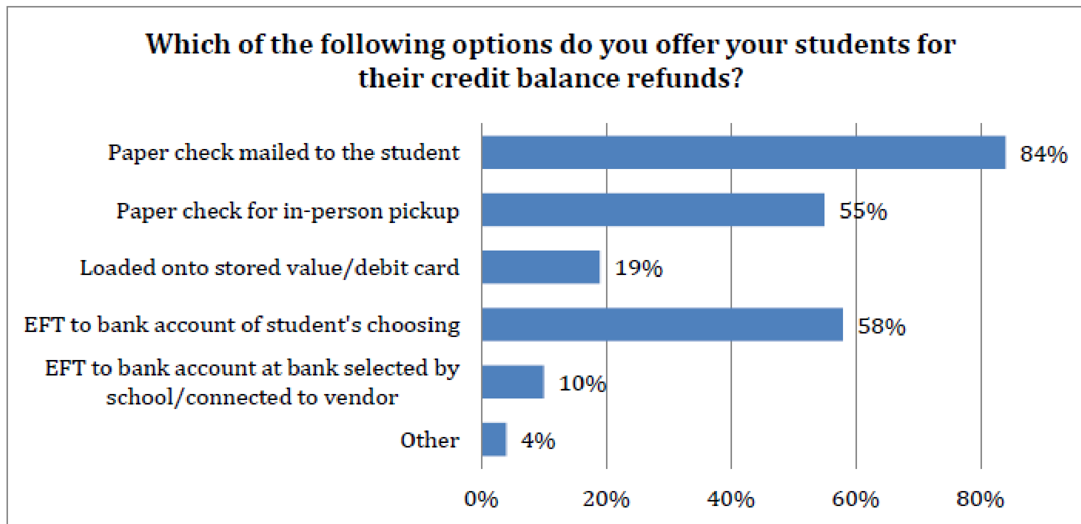
Moreover, and more importantly, this broad scope would have a chilling effect on the offering of accounts designed for students and would deprive students of choice and access to valuable, low-cost, and convenient access to bank services, accounts that can be especially useful to those students who arrive on campus without a bank account. For these reasons, we have urged the DOE to reconsider its draft regulation so it does not cover these traditional bank products and services to the extent they are offered outside of disbursement services (i.e., to

the extent the deposit account opening process is not integrated within the federal student aid credit balance disbursement process).

In addition to our concerns regarding non-Title IV disbursement accounts and services, we are concerned the proposed regulation will effectively eliminate federal student aid credit balance disbursement accounts — that is, accounts specifically designed to disburse federal student aid credit balances—to the detriment of students and educational institutions.

Federal student aid is disbursed directly to colleges and universities, which use the funds to satisfy a student's tuition expenses and then disburse the remaining funds to the student to be available for other appropriately related purposes. The DOE has issued a series of student aid credit balance disbursement regulations, which have increased the operational complexity of disbursing these funds to students. Financial service providers have partnered with educational institutions to help these educational institutions satisfy the DOE disbursement requirements. These arrangements enable colleges and universities to reduce the costs of disbursing federal student aid credit balances by utilizing direct deposit, rather than mailing paper checks, thereby decreasing costs for students and schools and provides to students, safe, quick, and convenient access to funds. In some of these arrangements, financial institutions may offer students a deposit account within the credit balance disbursement process itself or, when instructed by the educational institutions, provide them with a prepaid card to access federal student aid credit balances, particularly where a student does not have a pre-existing account to accept a direct deposit of funds. Most importantly, these products and services are always offered as options and are never a requirement. As evidenced by the chart below, institutions of higher education offer students a variety of options for receiving excess student aid funds. Paper checks along with ETFs to a bank account of the student's choosing are the most prevalent methods for disbursing these funds.[18]

[18] NACUBO response to CFPB request for information on campus products and services, March 2013. http://www.nacua.org/Documents/NACUBO_LetterToGarryReeder.pdf




For those students who do not have, or cannot easily access, an existing bank account, a letter from the National Association of College and University Business Officers (NACUBO) notes, "campus banking relationships can streamline the process of establishing a new account or a pre-paid card option provides an alternative to a check."[19]

The draft regulation presented by the DOE during the aforementioned negotiated rulemaking would effectively deprive students and educational institutions of these services by compelling financial institutions currently providing such "sponsored accounts" – including those in no way opened in connection with the credit balance refund process – to stop providing them to tens of thousands of students on multiple campuses. Draft regulation would restrict nearly all income sources associated with the maintenance and use of these products. With limited or no means to support the cost of providing the services, providers may have no choice but to exit the business and close existing accounts.

The result would be thousands of students losing a convenient, safe, and quick option to access their federal student aid credit balances, and the convenience of a single card that – at the

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[19] NACUBO response to CFPB request for information on campus products and services, March 2013. http://www.nacua.org/Documents/NACUBO_LetterToGarryReeder.pdf

election of the student – can combine financial and school functionality. Payments to students via checks would be more prevalent, especially for those without bank accounts, delaying the students' access to the funds and potentially causing them to incur off-campus check cashing fees. In addition, it is worth noting the CFPB found that requiring disbursement through electronic fund transfer can reduce fraud and costs.[20]

CBA is hopeful all involved in this process come to understand how banking relationships on campus provide students access to a range of financial products and options to meet their needs. It is especially important that the function of providing general financial services is not adversely affected by concerns over the separate issue of making federal aid funds available to students who wish to have funds deposited directly into a bank account, instead of being given cash or a check.

**Conclusion**

CBA Members remain proud of the work they do to provide products and services for college students. Whether it is a private student loan or a student checking account, CBA Members want to offer these products in a way which best serves their consumers. As students continue to better themselves and their economic prospects by earning high education degrees, the nation's retail banks will continue to develop services that allow them to prove themselves worthy of these prospective customers.

Thank you for the opportunity to testify on behalf of CBA's Membership. CBA looks forward to the opportunity to work with Congress to ensure millions of Americans can pursue education that meets their needs and aspirations.

[20] "Perspectives on Financial Products Marketed to College Students": Presentation to the Department of Education Negotiated Rulemaking Session. March, 26, 2014 (pages 3, 7).