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TESTIMONY

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

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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.

<u>IV. Conclusion</u>

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.