Testimony Submitted by the Consumer Bankers Association

To the Senate Committee on Banking, Housing and Urban Affairs,

Subcommittee on Financial Institutions and Consumer Protection

For the Record of the Hearing "Student Loan Servicing: The Borrower Experience"

June 4, 2014

Chairman Brown and Ranking Member Toomey, thank you for the opportunity to submit testimony on behalf of the Consumer Bankers Association's (CBA) membership for the hearing on "Student Loan Servicing: The Borrower Experience" before the Senate Banking Subcommittee on Financial Institutions and Consumer Protection. Our members, which includes most of the major players in the private student loan market, pride themselves on their focus on their customers—students and families needing the funds necessary to attend college. This is an important yet complex topic, and our members hope their perspective will provide some useful information on private student loan servicing and lending.

The Consumer Bankers Association (CBA) is the trade association for today's leaders in retail banking - banking 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 business. 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.

CBA's Education Funding Committee is composed of ten of the most active participants in the private student loan market. Our members are proud of the products they offer to their customers, which is underscored by a low number of complaints to the CFPB and positive loan performance. Only .03 percent of private student loans received a complaint over the last six months according to numbers from the CFPB. According to a recent report from MeasureOne, private student loans have a relatively low default rate of about 3 percent, which appears to far outperform federal loan programs.

Today's Student Loan Market:

Understanding the borrower experience with student loans entails understanding the major changes in student lending made in the last five years. The most fundamental of these changes was the termination of new originations in the Federal Family Education Loan Program (FFELP) in 2010. As a result of this change, approximately 94 percent of all student and parent loans are made by the federal government today.

Private education loans make up a very small but nonetheless important part of families' means of financing college.

Although federal loans now make up 94 percent of all student and parent loans, private loans are essential to hundreds of thousands of students and their families seeking to attend the college best meeting their educational goals and career aspirations. Private sector organizations, including banks, make these loans. As of the end of 2013, there were $1.2 trillion in federal student loans outstanding, but only $90 billion in private student loans, according to the Private Student Loan Survey published by MeasureOne[1]. (The data analysis firm MeasureOne surveyed the seven largest private student loan lenders that make up about 95 percent of the private loan market and drew from public sources for federal data).

Thus, as Congress looks at student loan policy, especially the issue of student debt, it is important to remember private lenders have become relatively small players in the student loan business, which is near totally dominated by U.S. Treasury-financed loans made by the Department of Education.

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[1] *The MeasureOne Private Student Loan Report 2013* - http://www.measureone.com/reports

Private student loans mainly serve to supplement federal loans, or are made to people who prefer to deal with the private sector instead of the government. It is important to CBA's members to participate in this market in order to offer a full range of products to their customers. CBA members want their customers to achieve their life goals – making them better customers– and a great part of achieving success is a good education. Many studies have shown those who have graduated college earn substantially more than those who only finish high school[2].

Low Delinquency and Default Rates on Private Student Loans:

Data compiled in the MeasureOne 2013 survey of private student loan lenders shows a delinquency rate of 90 days or more of only about <u>3 percent</u> for private student loans. Charge-offs also dropped to about 3 percent in 2013. Almost 75 percent of private student loans are in active repayment status, as opposed to deferment or forbearance, a high rate which again illustrates private student loan borrowers are successfully managing their repayment obligations. This represents a significant, across-the-board improvement over the past five years.

Importantly, private student loans carry no government guaranty, so if they are not repaid, the lender loses. For a lender to offer a sound private loan product, the lender must put loan applications through a robust underwriting process, where a determination is made based on a variety of financial factors as to whether or not the potential borrower is likely to be able to repay their loans. In most cases, private loan borrowers have also borrowed via federal loans, so lenders must carefully weigh the risk in making a loan.

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[2] Daly, Mary, and Leila Bengali. 2014. "Is It Still Worth Going to College?" *Federal Reserve Bank of San Francisco, Economic Letter*

Before making a private student loan, a lender must provide a long and thorough list of disclosures to the borrower at three different points in the application process. These disclosures include detailed terms and conditions as well as a notice to be sure and look into federal aid.

The vast majority of private student loans are co-signed, which results in a better interest rate and terms than a student would be able to get on his or her own. This also puts another practical check on a student's academic plans since a third party, such as a parent or grandparent, is highly likely to make sure their student is on a path to succeed at school before taking on the potential responsibility involved with co-signing a loan.

Nearly all private student loans made by the seven largest lenders for students seeking an undergraduate or graduate degree must be certified by the school to be attended before the lender will make the loan. (Ninety-six percent of loans made in 2013 were school certified.[3]) The only exceptions are for a narrow group of students who need to borrow for expenses while studying for post-graduate purposes, such as to take the Medical Licensing Exam or the Bar Exam – situations where their former school is not directly involved. School certification is not required by law, but it is a sound lending practice and one which also helps ensure the success of the borrower in loan repayment. Private lenders work with schools to help them keep track of how much their students are borrowing, which reduces over-borrowing and the risk of fraud.

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[3] Feshbach, Dan. "Private Student Loan Performance." MeasureOne. Gaylord National Resort and Convention Center, National Harbor, MD. 1 April 2014. Student Lending Forum.

Private student loan lenders offer products geared to their customers' needs and strive to offer the highest quality level of service to their customers.

One of the main incentives for CBA member banks and other entities in the market to offer private student loans is to connect with customers and hopefully form a long-standing relationship to help fulfill their future financial needs. This means private lenders are strongly motivated to provide excellent service to their customers*. According to the Consumer Financial Protection Bureau, only 0.03 percent of private student loan customers made complaints during the most recent six-month reporting period, a low rate that demonstrates high customer satisfaction.* With this in mind, our members view one valid complaint as one too many. Customer relationships are their top priority. Let's not forget that complaints are not verified by the CFPB and can cause consumer confusion about private student loan products.

The private sector continues to innovate, with new products, including refinancing and fixed-rate loans, being introduced thanks to consumer demand.

A few years ago, more customers began asking about fixed rate private student loans. Lenders quickly recognized the demand and began offering fixed-rate loans in addition to the traditional variable rate private loans. Competition among lenders quickly led to almost all of the major lenders offering consumers a choice of fixed or variable rate loans. Statistics differ between banks, but overall new loans are fairly evenly divided between variable and fixed-rate loans.

Like with other financial products, consumers have the choice of the security of a fixed rate, which will be higher since the lender absorbs the interest rate risk, or a lower variable rate which could change.

Variable rate loans have been extraordinarily low for the past several years, making them a bargain by historical standards for those who expect to repay most of their loans fairly quickly.

Recently, we have heard much discussion about the need for refinancing both of federal and private student loans. While it is up to Congress to decide if it wants to permit refinancing of federal loans, refinancing products are now widely available and more are coming to the market in the private sector. One irony is that private lenders interested in offering to refinance federal loans apparently could face sanctions by the Consumer Financial Protection Bureau. Most are therefore reluctant to act until it is clear they won't be punished for offering a less costly loan to consumers because the loan is not eligible for federal income based repayment programs. CBA urges the CFPB, with the support of Congress, to make clear institutions won't be penalized for offering their customers well-informed choices to refinance their federal student loans.

CBA's member banks have asked their prudential regulators for more flexibility to work with borrowers who are having problems.

For example, in a March 2013 letter, banks asked for the ability to grant forbearances and deferments similar to what is offered to federal borrowers and for the ability to modify repayment plans without having to charge off the loan[4]. As a result, prudential regulators have worked with our banks and some progress has been made. For example, CBA members are now permitted to extend borrowers' grace period to up to 12 months before the first loan payments have to be made. In addition, CFPB Director

[4] CBA Letter to Ben Bernanke, Chairman, Board of Governors of the Federal Reserve System; Thomas Curry, Comptroller of the Currency, Office of the Comptroller of the Currency; and Marty Gruenberg, Chairman, Federal Deposit Insurance Corporation, March 27, 2013 - http://www.cbanet.org/documents/2013%20Comment%20Letters/032713_CBA-Letter-to-OCC-FDIC-&-Fed-Requesting-Flexibility-on-Student-Loan-Repayment-Options.pdf

Cordray made comments at the 2014 Boulder Summer Conference on Consumer Financial Decision Making stating the Bureau is working with regulators on this issue. We urge the regulators to continue these discussions so banks may act for the good of student loan borrowers. Student loan borrowers are different from other borrowers in that they may need time when they first leave school to get a job, but their financial situation is expected to improve significantly over time. It only makes sense for lenders to be able to give them that time without being forced to give up on them repaying their loans, which may hurt their credit rating.

CBA member banks strive to comply with the Servicemembers Civil Relief Act (SCRA) but are concerned about conflicting requirements from the federal government.

Our members wish to ensure that every servicemember entitled to benefits under the Servicemembers Civil Relief Act receives them, without having to surmount unnecessarily burdensome documentation or other barriers that could preclude or delay their receipt.

Unfortunately, conflicting statutes and restrictive regulatory guidance on how federal student loans are to be handled under the SCRA have worked to obstruct full achievement of this goal. CBA joined with two other trade associations last month in a letter to Education Secretary Arne Duncan asking the government to address this issue as soon as possible[5].

The letter notes our support for simplifying the documentation and notification process required so servicemembers may receive an interest rate reduction as well as other benefits they are due without

[5] CBA Letter to Arne Duncan, Secretary, Department of Education, May 21, 2014 – http://www.cbanet.org/documents/2014%20Comment%20Letters/2014-05-21%20CBA-SLSA-EFC%20Letter%20to%20Secretary%20Duncan.pdf

unnecessary bureaucratic barriers precluding or delaying their hard-earned benefits. The letter also asks the government to allow greater flexibility in the documentation requirements in determining SCRA eligibility, assuring servicemembers receive their benefits, without undue burden or delay, while not penalizing lenders and servicers for complying with the government's previous guidance.

Conclusion

CBA members are proud of their record of responsible lending to make higher education possible for millions of students over many years. Our members are working in a competitive marketplace to improve their customer service, first and foremost by lending to students who are expected to be able to repay their loans. The private sector's flexibility allows it to offer products, like refinancing demanded by customers, but our banks are heavily regulated and constantly scrutinized by the federal government, so they must take great care to comply with regulatory mandates.

We believe our story is one of great success - in helping Americans achieve their dream of a higher education which leads to a successful and productive career.

Thank you for the opportunity to submit this testimony for the Record, and please feel free to contact CBA at any time if you have questions.