

October 31, 2007

The Honorable George Miller  
Chairman  
Education and Labor Committee  
U.S. House of Representatives  
Washington, DC 20515

Dear Chairman Miller:

As you consider legislation to reauthorize the Higher Education Act of 1965 the undersigned groups representing students, consumers, college presidents and administrators, urge you to include reforms to private student lending. Over the past decade private, non-federal student lending has grown significantly and now accounts for about a quarter of all educational borrowing. These loans are more expensive, have more stringent repayment requirements, and provide fewer protections than federal loans. Moreover, private student loans exacerbate student indebtedness because they provide the worst rates and terms to those students with the greatest financial need. This result directly contradicts the public policies underlying the federal student aid system, which attempts to place a college education within reach of low and middle-income students.

Recent research suggests a number of distinct problems with the current private student loan system, notably that:

1. The current private loan market is so opaque that consumers can't effectively compare the costs and benefits of various loans.
2. Private loans lack basic borrower protections.
3. Borrowers take out private student loans when they should not need to borrow at all, or when there are federal loans available.

To reform private student lending and provide some protection for borrowers requires a number of federal policy changes. Fortunately many of these policies are included in three pieces of legislation: H.R. 890, the Student Loan Sunshine Act, passed in the House; the Private Loan Transparency and Improvement Act passed unanimously out of the Senate Banking Committee; and S. 1561 introduced by Senator Durbin to reform current bankruptcy law. Together these policies provide the nucleus of a meaningful reform policy.

We respectfully ask that any new student private loan legislation be based on the following principles:

- Eliminate unsustainable loans and develop fair underwriting standards;
- Eliminate incentives for schools and lenders to steer borrowers to abusive loans;
- Improve disclosures so that borrowers can know the true cost of private loan products and understand the difference between private and government loans;
- Require accurate and accountable loan servicing;
- Ensure effective rights and remedies for families caught in unaffordable loans;
- Preserve essential federal and state consumer safeguards; and
- Improve assistance to distressed borrowers.

**Problem: Borrowers take out private loans when they should not need to borrow at all, or when there are federal loans available.**

A recent report by the Institute for Higher Education Policy looked at 2004 graduates with private student loans. In "The Future of Private Loans: Who is Borrowing and Why?" IHEP found that 20% of dependent and 50% of independent undergraduate students with private loans did not

exhaust their federal student loan options.<sup>1</sup> A number of factors result in the overutilization of private student loans including the growing direct to consumer marketing of private loans and the complexity of the financial aid process. However, schools like Barnard College and Colorado State University have found that providing additional information to borrowers can decrease the demand for private loans.<sup>2</sup>

### **Solutions:**

If students are to discern the differences between federal and private student loans schools and lenders must help clarify the differences.

First, schools and lenders should be prohibited from “co-branding” private student loans. By implying that a private loan receives the endorsement of the school, students are led to believe that the loan is something other than an unsecured source of credit with almost no borrower protections. The Student Loan Sunshine Act includes language prohibiting schools from entering into co-branding arrangements while the Private Loan Transparency and Improvement Act bans lenders from the practice. We recommend incorporating both provisions into a comprehensive ban on the practice.

Second, schools must clearly distinguish private student loans from other sources of financial aid in award materials. Private student loans are a means of financing higher education, not financial aid. Award letters and statements should make this distinction clear for families. The Sunshine Act encourages schools to make this distinction by mandating schools communicate private loan information distinct from federal loans. We recommend including the Student Loan Sunshine Act provision on private loan packaging.

Third, students should be clearly and repeatedly notified about their eligibility for federal student loans at lower interest rates and more favorable terms than private loans. In particular students should be notified about their options before taking out a private loan. The Student Loan Sunshine Act mandates that any school that provides information about private loans must clearly spell out that the rates are less favorable. In addition it mandates that in any private loan advertisement, solicitation or application borrowers are informed about their eligibility for federal student loans regardless of their financial need. The Private Loan Transparency and Improvement Act includes an additional provision mandating notification of federal loan eligibility once the private loan is approved but before it's signed. We recommend including the Student Loan Sunshine Act provision on federal loan eligibility notification with the addition of the Private Loan Transparency and Improvement Act provision for additional notification.

Fourth, private loans should be certified by the school before the loan can be consummated. Certification should ensure that the student is not borrowing private loans greater than the cost of attendance minus aid. Because private student loans are non-dischargeable in bankruptcy, lenders should be obligated to prove that their educational loan is in fact being used for educational purposes. Furthermore, certification will offer schools the opportunity to provide additional education to borrowers about loan costs, personal budgeting, and federal loan eligibility in the model of Colorado State University and Barnard College. This notification will have the additional benefit of helping to track the growth and change in private student borrowing. It will also provide college financial aid officers with information about the terms and conditions of private loans that their students are receiving. The Student Loan Sunshine Act mandates lenders notify schools if a student takes out a private loan larger than \$1,000. We recommend that the Sunshine Act language be strengthened to require lenders to certify all private student loans.

<sup>1</sup> The Institute for Higher Education Policy, *The Future of Private Loans: Who's Borrowing and Why?* (December 2006), available at <http://www.ihep.org/Pubs/PDF/FutureofPrivateLoans.pdf>

<sup>2</sup> Scott Jaschik, *Bucking the Tide on Private Loans?*, InsideHigherEd.com. July 16, 2007. <http://www.insidehighered.com/news/2007/07/16/barnard> and Lindsey Luebchow, *Colorado Does Student Loans Right*, New America Foundation. August 23, 2007. [http://www.newamerica.net/blogs/education\\_policy/2007/08/colorado\\_state](http://www.newamerica.net/blogs/education_policy/2007/08/colorado_state)

Finally, private loan companies should be required to report loan information to the Department of Education. Including this information in the National Student Loan Data System will assist colleges and policy makers in better tracking borrowing trends. This requirement is not currently in a legislative proposal.

**Problem: The current private loan market is so opaque that consumers can't effectively compare the costs and benefits of various loans.**

Recent research by Consumers Union shows that when lenders describe the rates and terms of private educational loans in an understandable and uniform format, students and parents have the ability to comparison shop to make informed borrowing decisions.<sup>3</sup> Unfortunately the current private loan marketplace is confusing and that information necessary to make an informed borrowing decision is either missing or is inconsistent.

**Solutions:**

First, lenders should be required to provide a full and accurate APR rate quote before borrowers are presented with the promissory note to sign. The Private Loan Transparency and Improvement Act requires lenders to provide clear and concise disclosure regarding the APR, rate, fees, terms and conditions of their private educational loans in all solicitation, approval and loan consummation materials. We support and recommend including the provision of the Private Loan Transparency and Improvement Act that requires lenders to provide consumers a uniform private educational loan statement describing the rates and terms of the loan once they have been approved for the loan.

The timing of this statement is very important because it allows consumers time to comparison shop to find the best loan. We recommend that the required statement include three additional items to fully describe the loan: (1) the highest rate to which a loan's variable interest rate can rise (if applicable), (2) the monthly repayment amounts given the initial interest rate and the maximum rate possible (if applicable), and (3) the total amount repaid over the term of the loan given the initial interest rate and the maximum interest rate (if applicable). These items inform borrowers about their projected and possible monthly repayment amounts. Consumers need to be informed of these amounts to determine whether they can afford the loan given the initial interest rate and maximum interest rate possible.

Second, all private student loans should be subject to the Truth in Lending Act (TILA) regardless of their size. We recommend updating TILA's current \$25,000 jurisdictional limit, which was passed in 1968, to 2007 dollars (approximately \$150,000). The Private Loan Transparency and Improvement Act eliminates this limit for student loans, but we believe that the better approach is to update TILA to 2007 uniformly for all loans.

**Problem: Private loans lack basic borrower protections.**

Borrowers who exhaust their federal loan options and decide to use private educational loans to finance part of their education will find their loans lack basic protections. Notably, due to changes in the 2005 Bankruptcy law, all student loans are harder to discharge in bankruptcy than any other type of consumer credit.

**Solutions:**

First, provide borrowers with a basic cooling off period to consider the terms of the loan that has been approved before the loan is consummated. The Private Loan Transparency and Improvement Act provides a 30-day period after the loan offer is made during which the offer is locked in and the borrower may choose whether or not to consummate the loan. Once the loan is consummated borrowers have a 3-day period in which to cancel the loan. During this period no

<sup>3</sup> Consumers Union, Helping Families Finance College: Improved Student Loan Disclosures and Counseling (July 2007), available at <http://www.consumersunion.org/pdf/CU-College.pdf>.

funds may be transferred. We support this provision.

Second, students should be able to return and repay private student loans without penalty for a period of time after the loan proceeds are disbursed – which sometimes happens before the students have significant contact with school financial aid offices. We recommend that students should be able to repay private student loans for six months following disbursement without an prepayment penalty or any liability for up front fees other than interest that has accrued.

Third, treat private loan borrowers the same as other borrowers of consumer credit during bankruptcy. Private student loans reflect an investment by the student in their own education and by extension an investment in the health of our nation. Our federal policies should reflect the value we place on education, encouraging borrowers to invest in their own education. By punishing educational borrowers more harshly than any other type of debtors, our bankruptcy policy currently runs counter this philosophy. We recommend including S.1561, legislation introduced by Senator Durbin to allow for private loan dischargeability in bankruptcy.

The College Cost Reduction and Access Act took serious steps to help students manage their federal student loan debt. As lenders more aggressively market their private educational loans it is important that we have a system to help students make good financial choices, minimize over-borrowing and provide a basic threshold of borrower protections. We urge you to include these recommendations to complement your effort to help students and families keep college affordable.

Sincerely,

American Association of Collegiate Registrars and Admissions Officers  
American Association of State Colleges and Universities  
Consumer Federation of America  
Consumers Union  
National Consumer Law Center (on behalf of our low income clients)  
New America Foundation  
Project on Student Debt  
U.S. Public Interest Research Group  
United States Student Association

cc. Representative McKeon  
Representative Hinojosa  
Representative Keller