Hearing of the Senate Committee on Banking, Housing, and Urban Affairs
April 15, 2008

Testimony of Sarah Flanagan
Vice President for Policy Development
National Association of Independent Colleges and Universities
Washington, D.C.

Mr. Chairman and Members of the Banking Committee –

Thank you for holding this important hearing today. My name is Sarah Flanagan and I am Vice President for Policy Development at the National Association of Independent Colleges and Universities (NAICU). Our association represents 953 of America's private colleges – from the Ivy League to women's colleges to historically black colleges and universities to a myriad of faith-based institutions representing the full diversity of our nation's people, history, and collective intellectual traditions.

I am both honored and proud to share this panel today with Pat McGuire, president of Trinity Washington University, not only because I so admire her and her institution, but because Trinity is the perfect example of the kind of institution that composes our association's membership. Trinity is small, it is lean, it is personal, it is innovative, and it is a jewel of diversity, opportunity, and hope. When they hear the term "private college," Americans most often think of the acknowledged higher education superstars such as Harvard, Yale, and Princeton. However, Trinity is much more typical of the nation's 1,600 private colleges – in wealth, in purpose, and in size.

For example, if you were to remove the 45 private colleges with endowments above a billion dollars from consideration, the remaining 1,555 have a median endowment of $14 million. Most private colleges rely heavily on tuition to remain financially sound, doing the best they can to offer a high quality college education to all students, regardless of their economic means. It may surprise you to know that, while private colleges are misperceived by many as serving only the affluent, our institutions in fact educate the same proportion of low-income, high-risk, and minority students as four-year public colleges and universities.

Also defying conventional wisdom, many families find that when their aid offers arrive from private colleges, the net tuition they actually will pay is comparable to the cost of their local public college. This is because private colleges provide a huge amount of grant aid from their own funds.

Still, not all private colleges can make up the difference in cost for every family. This means that some students are unable to cover tuition and fees through the federal student loan programs. This is not surprising. The federal government has limited student borrowing under the federal programs, both to keep students from acquiring too much debt at a young age and because of federal budget constraints. When the federal student loan programs began in 1965, freshmen

could borrow $2,500. It wasn't until 1981 that limit was increased – and that was only to $2,625 to cover a new loan origination fee.

The current academic year marks the first time since 1965 that freshman loan limits have truly been increased, to $3,500. Upperclass students have higher limits, but the maximum for juniors and seniors is capped at $5,500. In 2007-08, new federal student loans totaled $80 billion – $15 billion with direct federal capital and the rest through the bank-based federal student loan programs.

Fortunately, there are additional sources of federal loans. Creditworthy parents of dependent undergraduates can borrow up to the full cost of attendance in the federal PLUS loan program. And adult students, or dependent students whose parents can't meet the PLUS credit test, can borrow an additional $4-5,000 in federal loans. For the few students attending colleges with sufficient Perkins loan funding (formally called National Defense Student Loans), they can help meet their financial needs through very low cost loans under that program. But Perkins funding is rapidly drying up under the administration's continuing attempts to eliminate the program, and repeated cuts by Congress in the program's funding.

The net effect of these limits on the federal student loan programs has been a burgeoning private student loan market. Reliable data on the private student loan market is hard to find. However, the College Board estimates that over the past ten years private student loans have grown to more than $17 billion, from $1.6 billion in 1996.

Who are these borrowers? For the most part, students at private, non-profit colleges are relying on these loans as a last resort. They have hit their borrowing limits in the federal programs, the school's financial aid fund has been tapped dry, and they need additional funds to get to graduation. Private loans have become a limited and imperfect, but essential access tool for these students.

The NAICU Survey

As the pressures on financial markets reached the front pages, NAICU thought it would be wise to survey our members, to determine how the larger market problems might affect student lending. Like these other markets, student lending has changed a great deal in the past decade. As with other types of consumer loans, the financing markets supporting student loans has become turbulent and much more expensive, as a result of the well-publicized failure of the auction rate securities market. Our survey was an attempt to get a quick snapshot of current and potential effects, if any, of all this economic turmoil on our colleges and their students.

NAICU surveyed its 953 member institutions between March 3 and 14. A total of 315 institutions responded, for an overall response rate of approximately 33 percent. A copy of our survey and details of our findings are attached to my testimony. We were relieved to find that most schools are still able to secure commitments from lenders to provide their students loans.

However, there are some warning signs. Let me highlight a few of our key findings.

Of the nearly nine out of ten respondents that participate in FFELP loans, well over half said that one or more of their lenders are no longer providing FFELP loans. So far, this gap is being filled by other banks.

On the private student loan side, the signs are a bit more troubling – especially in the percentage of schools relying on private loans who told us that these loans were important to their institution's financial stability.

Of the close to 300 respondents participating in private-label loans, 60 percent said that private student loan borrowing was either very important or critically important to their institution's financial health. The rest viewed private-label loans as somewhat important, not very important, or not at all important.

Well over half of the responding institutions reported receiving information from "preferred" lenders about the lenders' ability to make non-federal private label loans for the 2008-09 academic year. Almost half said that one or more of their lenders are tightening credit requirements for private label loans, and over 40 percent had been told that one or more of their lenders would no longer be providing private label loans. Also, 30 percent of this group had been told that one or more of their lenders are reducing or eliminating borrower benefits, and 20 percent reported lenders saying that they are increasing interest rates.

Timing Is Everything

Since we closed this survey on March 14, storm clouds have continued to gather. Following up on our survey findings that private non-federal lenders were putting more credit requirements into place, one state surveyed its members whose students rely on these loans to see how many of the students could meet the new credit requirements. The news was not good. Several colleges fear that their financial stability could be at risk, and nearly every college expects to lose some students if something isn't done to ensure supplemental loan funding for students with the greatest financial need.

Tightening credit requirements is not all bad – particularly if an institution's default rates on federal loans give evidence that students may not be able to handle additional debt. But losing supplemental loan funding for all students at all colleges could pose an insurmountable barrier for many worthy students at worthy colleges.

This month begins a critical time in student lending. The high season of the college loan business is about to begin. On the first of this month, the last batch of colleges mailed out their college acceptance letters to millions of American students. This week, families of accepted students are opening letters that detail what the college will provide in financial aid. Families have only between now and May 1 – when deposits are due – to make their final choices. As we

sit here today, families across the nation are sitting down, comparing options and making these tough decisions, factoring in the types and amounts of student loans they have been offered.

From May until late August, the loan process will be in high gear. Colleges will certify to the lender the student chooses that the student is actually enrolling, the amount and type of loan aid they have requested, and their eligibility for that aid. Loan applications and promissory notes will fly between families, colleges, and lenders as the fall semester approaches.

This year, though, there is an additional overlay to this annually stressful period for all parties. Many student lenders historically have relied on the auction rates securities market for funding. Today, though, our institutions are concerned that if lenders can't rely on this traditional source of funds, and then can't lock in reliable alternative funding for both federal and non-federal student loans, the lenders may find themselves without the capital demanded for the peak processing season. Simply put, many of our institutions are anxious that the financing markets might worsen between now and September, and that in the in the middle of this peak processing season, their lenders might curtail or stop making student loans.

Let me emphasize that we are not in a crisis. We know of many colleges that have lost lenders, but all are working successfully to find new lenders to fill the gap. However, as more and more lenders drop out, colleges are increasingly concerned about overall market liquidity. Adding to this worry are problems many of them are facing in refinancing their own institutional bond debt, or in the increased cost of this debt.

The students graduating from high school in the coming weeks, and planning on college in the coming months, don't have the option of waiting for the market to improve. The same can be said of those returning college students whose parents qualified for a PLUS loan last year, but because of the family's difficult financial situation this year may have to go to last-resort private lending. They – and we – wish there were no need for any family to borrow for a college education. However, in limited circumstances when private lending is necessary, the only thing more expensive than taking out a private student loan is not finishing college at all.

Let me add a final note of caution. Some players in the private student loan market have not simply provided last-resort loans for students likely to succeed, but have engaged in predatory direct-to-consumer lending practices. That is why a second piece of legislation this committee has been working on, and is now in conference as part of the Higher Education Act reauthorization, is also important. The bipartisan "Private Student Loan Improvement and Transparency Act" creates new protections for students that we enthusiastically support. The bill promotes responsible borrowing by effectively eliminating direct-to-consumer educational loans, making even private educational loans pass through a college financial aid office to ensure that students first borrow through less expensive federal loans, and that they are not borrowing for unnecessary luxuries. We thank this committee for its work on this legislation, and believe it essential to add these basic consumer protections to the private student loan system.

The education committees in both the House and Senate are working on contingency plans to secure liquidity in the federal student loan programs. They are doing this, first, by increasing the current authority of the Department of Education to allow it to act as a secondary market for bank-based loans. Second, they are modifying the lender of last resort program to make it better able to respond to the current market situation. Finally, they are providing some modest increases in the federal student loan program loan limits.

Still, at the end of the day, we will have some students that – for their own good reasons – will need to borrow in the private market to complete their education, or to enter the college that best meets their educational needs. That is why we hope you will consider taking steps to ensure that there is also liquidity in the private student loan market for those who need to borrow, and for whom private borrowing is appropriate.

Wisely used, student loans are good loans – and not just because of the return on such an investment that we realize as a nation. Student loans also are a good financial investment. This is nothing short of amazing and, in fact, counterintuitive. Traditional students come to college with little or no credit history. Those that need to borrow the most are the poorest. In purely economic terms, this sounds like a high risk portfolio.

However, the numbers show that the opposite holds true. Private colleges and universities in particular have a default rate in the federal student loan programs of 2.4 percent, compared to the national default rate of 4.6 percent. This is a proud record for a loan program in which the collateral is simply an improved mind – not a car or a boat or a home that can be reclaimed and resold.

Such success is a remarkable tribute to the diverse, flexible, engaged, and transformative nature of our nation's higher education system. It also is a tribute to the American spirit of individualism and personal achievement. Student by student, people from all walks of life pore though the books, trudge to the classes, and labor over the papers that somehow make each one a different person in the end – someone who can serve as an engaged citizen, build a career, contribute productively to our nation's economy, and ultimately repay the student loan that made all of this possible.

Mr. Chairman and members of the committee, we realize the huge challenges you face as you work to protect our economy from a crisis in the housing market. However, as you look at fixes for that sector of the economy, we ask you to also remember the nation's homes of our minds, the enterprises that drive our knowledge-based economy – our colleges and the students they serve.

We hope we have no student loan liquidity crisis. Indeed, one may not occur. However, your early attention to the possibility of this emerging challenge will assure that our colleges and their students remain able to perform their essential role in our society.

####