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PRIVATE STUDENT LOANS: REGULATORY PERSPECTIVES

HEARING

BEFORE THE

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

ONE HUNDRED THIRTEENTH CONGRESS

FIRST SESSION

ON

EXAMINING THE SUPERVISION OF PRIVATE STUDENT LENDERS BY FEDERAL FINANCIAL REGULATORS AND WHAT ACTIONS LENDERS MAY TAKE TO WORK WITH BORROWERS TO AVOID DEFAULT DURING PERIODS OF HARDSHIP

JUNE 25, 2013

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C O N T E N T S

TUESDAY, JUNE 25, 2013

WITNESSES

Additional Material Supplied for the Record

PRIVATE STUDENT LOANS: REGULATORY PERSPECTIVES

TUESDAY, JUNE 25, 2013

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
Washington, DC.

The Committee met at 10:04 a.m., in room SD–538, Dirksen Senate Office Building, Hon. Tim Johnson, Chairman of the Committee, presiding.

OPENING STATEMENT OF CHAIRMAN TIM JOHNSON

Chairman JOHNSON. Good morning. I call this hearing to order.

For many Americans, a college degree is an important goal that can mean a lifetime of better earnings and opportunities. However, this goal has come at a higher price: the cost of education has risen significantly while the job market has weakened, straining a generation of Americans seeking to establish themselves in the broader economy. Student loan debt now stands at over $1 trillion and is second only to mortgage debt as the largest form of debt in the country. Student loan balances have almost tripled since 2004, and an alarming one-third of borrowers are delinquent on their loans. Last year, nearly eight out of ten students in my home State of South Dakota graduated with student loan debt.

These rising debts reach beyond individuals and impact many sectors of the economy. High levels of student loans mean many put off buying a home or never become homeowners at all. Student loans make it harder to start small businesses. Student loan payments often take priority over retirement savings. And rising student loan balances in States like South Dakota make it harder for graduates to stay in rural communities.

While most student loans are Federal, private loans make up $150 billion of the market. Private lenders allow many students to attend college who would not otherwise be able to afford it and may sometimes offer better terms than Federal loans. However, nearly 1 million borrowers are in default on their private student loans. And while Federal loans offer flexible relief during periods of hardship, most private student lenders do not offer the same options for struggling graduates.

Our witnesses today represent the Federal agencies responsible for ensuring that lenders balance sound lending principles with appropriate measures to avoid default. I look forward to hearing your testimony on guidance you provide to lenders and what limitations lenders may face in providing relief. The CFPB has been very active in private student loans, recently publishing a proposal to oversee large student loan servicers and a report on affordable private student loan repayment. I am interested to hear from the CFPB on both of these efforts.

Next week, on July 1, millions of students face a doubling of the interest rates on some Federal loans. I urge the regulators to be vigilant in monitoring growth in the private student loan market that may result from changes to the Federal student loan market. It is critical that regulators respond quickly to marketplace changes and that consumer protections are safeguarded when demand rises.

With that, I turn now to Ranking Member Crapo.

STATEMENT OF SENATOR MIKE CRAPO

Senator CRAPO. Thank you, Mr. Chairman, for holding this hearing today.

Student loans play a vital role in the lives of many students and their families across this country. The loans help maintain a strong and educated workforce by ensuring that all Americans can have access to higher education regardless of their financial circumstances.

Recently the New York Federal Reserve reported that student loan debt has risen to become the second largest household debt burden behind mortgages. The total outstanding student debt was $986 billion in the first quarter of 2013. Just 9 years ago, that number was $240 billion.

Several factors have contributed to this student debt explosion of the last decade, including college tuition rates that have significantly outpaced inflation and a record number of students and employees opting for school in light of the very tight job prospects in the market.

When discussing the student loan market, there is considerable confusion as to who is making the loans and how the loans are made. According to the CFPB, 85 percent of the total outstanding student debt is in Federal student loans, offered through the Department of Education. That is roughly $838 billion.

Private student loans, the subject of this hearing, make up 15 percent of the outstanding debt, and that market is expected to shrink even further. A recent Standard & Poor's report noted that new originations for Federal loans occupy roughly 94 percent of the market while private lenders originate the remaining 6 percent.

Much of the contraction in the private lending market is due to the restructuring of the Department of Education loan programs in 2010 to virtually eliminate private lenders. Other important considerations include the fact that Federal loans default on average three times as often as private loans. Federal loans do not undergo an underwriting process, and there is almost limitless spending for borrowers who take out Federal loans for graduate school.

With respect to private student loans, one concern I often hear is that banks do not offer enough borrower relief options. In the testimony submitted today, it appears that prudential banking regulators and the CFPB are offering conflicting guidance on borrower relief options. The CFPB is pressing for more borrower relief; however, the prudential banking regulators are concerned with how modified loans affect a bank's safety and soundness as well as whether they violate accounting rules.

Lenders have stepped up and expressed their willingness to help more troubled borrowers and cite that loan modifications may benefit both borrowers and lenders in certain circumstances. Today I hope we can get a better understanding of the obstacles that face us directly from the regulators.

I also would like to hear about how the regulators are working together to resolve this conundrum of providing student loan relief while not endangering the safety and soundness of the system.

Finally, since the vast majority of student loans are made by the Department of Education, we need to acknowledge that the Committee on Health, Education, Labor, and Pensions has a critical role in determining whether the Department of Education's student loan programs are helping the situation or binding students and their families into too much debt. I know all of my Senate colleagues want to find a solution to ease the burden on our young people.

Mr. Chairman, before we conclude, we received a letter from the Consumer Bankers Association and a letter from the Financial Services Roundtable regarding student loan issues, and I would request that both letters be entered into the record.

Chairman JOHNSON. Without objection.

Senator CRAPO. Thank you.

Chairman JOHNSON. Thank you, Senator Crapo.

Are there any other Members who wish to make a brief opening statement?

Senator REED. Mr. Chairman?

Chairman JOHNSON. Senator Reed.

STATEMENT OF SENATOR JACK REED

Senator REED. Thank you, Mr. Chairman. Thank you very much for holding this hearing, and we are reaching a tipping point with student loan debt, as you and Senator Crapo have illustrated, particularly as we approach July 1st with the potential doubling of loans on students who have the most need in our country.

Student loan debt, as both my colleagues have indicated, is really the next big financial crisis, and it could have a lasting impact on our economic growth and the prospects for the coming generation. We have seen student loan debt rise throughout the recession even as other household debt has fallen. And student loan debt, as my colleagues have indicated, is now the second largest outstanding balance after mortgage debt with respect to households. And this is affecting the life trajectory of generations of Americans, the young people today and, if we do not do anything, even their children.

Our students are caught between a rock and a hard place. The job market increasingly demands postsecondary education. At the same time, college is getting much more expensive. There has been a major cost shift in higher education. Costs have gone up. State support for public institutions has gone down, and as a result, tuitions are rising—in fact, exploding.

In the Federal student aid program, 68 percent of Federal student aid is in the form of loans, and I have the privilege of holding the seat held by Claiborne Pell. When Senator Pell introduced the Pell grants back then, the mix was much different. In fact, I believe it was 80 percent grants and 20 percent loans, and we have flipped, turned the whole thing over on its head. In fact, many of my contemporaries were the beneficiaries of that wonderful 80 percent grant to 20 percent loan effort, and we are not keeping up with that at the Federal level.

We have to keep these loans affordable. Low interest rates is part of the solution, and, again, it is distressing many of us that we are on the precipice of doubling the subsidized rate from 3.4 to 6.8 percent in just a few days.

Ironically, as we increase the rates—and my colleague from Massachusetts Senator Warren has pointed this out again and again—the Federal Government is making about $50 billion this year on their loans and is expected to make $180 billion between now and 2023. So there is a lot of money. It is just not getting to the young people that need it and their families.

We have got to work on both sides, and we have to recognize that we have to be back where we were, I believe, in the 1950s, 1960s, and the 1970s when we were actually using Federal resources to help people get to college, not using students to pay down the debt. And many of my colleagues are suggesting that we do precisely the latter, not the former.

So I look forward to today's testimony and the broader issue of private loans, but we really have a crisis that is before us.

Thank you, Mr. Chairman.

Chairman JOHNSON. Is there anyone else? Senator Brown.

STATEMENT OF SENATOR SHERROD BROWN

Senator BROWN. Thank you, Mr. Chairman. I appreciate Senator Reed's words. My wife is the daughter of a utility plant maintenance worker and a home care worker, and she graduated, first in her family to go to college, from Kent State 30—I will not say how many years ago—30-plus years ago with a student debt of about $1,200. I think that tells the story that he mentioned.

Thank you to the witnesses and thanks, Mr. Chairman and Senator Crapo, for holding this hearing.

In November 2009, I introduced legislation to create a private education loan ombudsman. These provisions were part of Dodd-Frank in 2010. Some 3–1/2 years later, it is gratifying to see the great work that CFPB's first Student Loan Ombudsman Mr. Chopra is doing with this office—thank you for that—speaking out about issues, helping borrowers get real relief.

About a year ago, my Subcommittee held a hearing on private student loans where Mr. Chopra and I discussed the discrepancy between the low rates at which banks borrow and the interest rates that they charge students, something that Senator Reed and Senator Warren both talked about. For example, the Nation's largest student loan lender borrows at an average rate of 1.4 or 1.5 percent, while the average private student loan borrower is paying more than 5 times that amount, some 7.9 percent. Mr. Chopra's testimony then noted and now notes that the increase in private student loan lenders' interest margins "may demonstrate a lack of competition, as well as an opportunity for more efficient private capital participation."

The president of the Nation's largest student lender said in January the margins here are really a function of alternative financing opportunities. We are making loans to parents and students, family education loans. Their alternatives are fairly limited.

Today I am proud to announce that my fellow Member of the Banking Committee Senator Heitkamp and I, along with Senators Durbin and Murray, are introducing legislation to create opportunities for borrowers to refinance their private student loans. The Refinancing Education Funding to Invest for the Future Act, or REFI for the Future, would authorize the Treasury Secretary, in consultation with the Education Secretary and the CFPB, to create a program to encourage competition and spur refinancing of private student loans. The most indebted student borrowers are the most likely to have private student loans. Of the $1 trillion that Senator Crapo mentioned in student loan debt, only about 15 percent, but that is still $150 billion, is in the private student loan market. It is something we can do something about. Senator Heitkamp's and my legislation will help to do that.

Thank you, Mr. Chairman.

Chairman JOHNSON. Senator Heitkamp.

STATEMENT OF SENATOR HEIDI HEITKAMP

Senator HEITKAMP. You know, a couple months ago, I hosted a housing tour across North Dakota. We have an acute shortage and affordability issues due to our economy as things grow. At the roundtables that I conducted, one issue came up over and over and over again, which is that young people cannot get entry into the market because they are not bankable. And they are not bankable because they are carrying thousands and thousands and thousands of dollars of student debt. And families talk to us every day and say, "How come at a time of record low interest rates we are paying 8, 9, 10 percent on our student debt?"

We cannot continue this. And we know from massive credit card interest that if we do not figure out a way, they will continue to pay the interest and never get out of the principal debt and never be bankable, never be able to get a loan to build a business, be entrepreneurial.

This is crushing the future of our economy if we do not deal with it, and this is a small point, obviously not the big part of student loan issues. We are concerned about the rates. But we are also concerned about giving those people with private loans an opportunity to refinance, just like you would if you had a mortgage.

And so I want to applaud Senator Brown for the work that he has done. I am proud to be on this, and I want to thank the Chairman and the Ranking Member for holding this hearing. This is an issue that will not go away. It is an issue that we will continue to work on until we know that we have secured a viable future for American families and they will not be buried under with student debt.

Thank you, Mr. Chairman.

Chairman JOHNSON. Thank you all.

I want to remind my colleagues that the record will be open for the next 7 days for opening statements and any other materials you would like to submit.

Now I will introduce the members of the panel.

Rohit Chopra—did I pronounce that correctly?

Mr. CHOPRA. Close enough.

[Laughter.]

Chairman JOHNSON. He is the Student Loan Ombudsman at the Consumer Financial Protection Bureau.

John Lyons is the Senior Deputy Comptroller for Bank Supervision Policy and Chief National Bank Examiner at the Office of the Comptroller of the Currency.

Todd Vermilyea is Senior Associate Director for Banking Supervision and Regulation at the Board of Governors of the Federal Reserve System.

Doreen Eberley is the Director of Risk Management Supervision at the Federal Deposit Insurance Corporation.

I thank all of you again for being here today. I would like to ask the witnesses to please keep your remarks to 5 minutes. Your full written statements will be included in the hearing record.

Mr. Chopra, you may proceed.

STATEMENT OF ROHIT CHOPRA, ASSISTANT DIRECTOR AND STUDENT LOAN OMBUDSMAN, CONSUMER FINANCIAL PROTECTION BUREAU

Mr. CHOPRA. Thank you, Mr. Chairman, Ranking Member Crapo, and Members of the Committee, for the opportunity to testify today.

It is clear that many in Congress are keenly interested in finding solutions to some of the troubling trends in the student loan market. Understandably, many policymakers across the country are seeking to address some of the underlying drivers of growing student loan debt, including the rising cost of tuition. However, it will also be prudent to address the large pool of existing debt owed by millions of Americans.

The Consumer Financial Protection Bureau estimates that outstanding student loan debt is approaching $1.2 trillion. While most of the market consists of Federal loans, 81 percent of our high-debt undergraduate borrowers used private student loans. And like a business, a consumer's ability to manage cash-flow is absolutely critical to his or her financial health.

Private student loan providers generally do not offer this cash-flow management option, which is available to borrowers of Federal student loans. And for private loan borrowers who default early in their lives, the negative impact on their credit report can make it even more difficult to pass employment verification checks or ever reach their dream of buying a home.

While risks in the student loan market do not appear to jeopardize the solvency of the financial system, the difficulties borrowers face when trying to manage cash-flow may have a broader impact on the economy and society. We recently published a report on what we heard from the public about these potential impacts.

The National Association of Home Builders wrote to the Bureau about the relatively low share of first-time homebuyers in the market compared to historical levels and that student debt can "impair the ability of recent college graduates to qualify for a loan." And when young workers are putting large portions of their income toward student loan payments, they are less able to stash away cash for that first downpayment.

In submissions by coalitions of small businesses, groups cited a number of factors about the threat of student debt. For many young entrepreneurs, it is critical to invest capital to develop ideas, market products, and create jobs. But high student debt burdens require these individuals to take more cash out of their business so that they can make monthly student loan payments.

The American Medical Association wrote that high debt burdens can impact the career choice of new doctors, leading some to abandon caring for the elderly or children for more lucrative specialties.

Student debt can also impact the availability of other professions critical to the livelihoods of rural communities. According to an annual survey, 89 percent of veterinary students are graduating with debt, averaging over $150,000 per borrower. Veterinarians encumbered with high debt burdens may be unable to make ends meet in a dairy medicine or livestock management practice in rural areas.

Classroom teachers submitted letters detailing the impact of private student loan debt, which do not always offer the income-based repayment options or loan forgiveness programs.

When there was concern about the domino effect of problems in the capital markets, policymakers took action. In 2008, distress in the credit markets led the Federal Government to enact policies to assist financial institutions to raise capital for student loan issuance. While programs like the ECASLA and TALF were primarily designed to assist financial institutions to originate more loans, understanding them might be useful for policymakers seeking to address some of the market failures faced in this market.

In our recent report on student loan affordability, we discussed a number of ideas put forth by the public. I want to briefly note two that might increase private capital participation and market efficiency.

The first is spurring loan restructuring opportunities. Most private student loans have few options available for alternative repayment plans. Policymakers might look to provide a path forward for borrowers in distress, creating a transparent step-by-step process that leads to affordable payment terms where monthly payments can match a reasonable debt-to-income ratio and repayment of the loans can be more affordable. This may be helpful to financial institutions as well who can recognize a higher net present value of loans in distress.

The second is jump-starting a student loan refinance market. For borrowers who have dutifully managed their monthly payments on high interest rate loans, many raised the need for a way to refinance. This approach could give responsible borrowers the opportunity to swap their loan for one with a lower rate. When mortgage borrowers and others see rates plummet, they try to refinance. Responsible borrowers should have that option, too.

Thank you for the opportunity to share insight on the state of the market, and I look forward to any questions you have.

Chairman JOHNSON. Thank you, Mr. Chopra.

Mr. Lyons, please proceed.

STATEMENT OF JOHN C. LYONS, SENIOR DEPUTY COMPTROLLER, BANK SUPERVISION POLICY AND CHIEF NATIONAL BANK EXAMINER, OFFICE OF THE COMPTROLLER OF THE CURRENCY

Mr. LYONS. Chairman Johnson, Ranking Member Crapo, and Members of the Committee, I appreciate this opportunity to discuss the OCC's supervisory approach to private student lending conducted by national banks and Federal savings associations. Promoting fair and equitable access to credit, including education financing, is a core OCC mission and one of our highest priorities.

Financial assistance is an important means of helping promote higher education in this country. National banks and Federal savings associations have a long history with Federal and private student lending programs, but they make up just 3 percent of the approximately $1 trillion in outstanding student loans in this country today. However, the private student loans offered by national banks and thrifts provide an important supplement for many students seeking to finance their educations.

For most consumer loans, such as auto loans, the underwriting structure and management of the loans are straightforward. The funds serve a specific purpose, and the source of repayment is well defined and easily assessed at the loan's origination.

Student loans, however, pose unique challenges for lenders and borrowers. For example, student loans often require a several-year commitment that extends beyond when the student starts school until repayment begins after the education is complete. Private student loans are usually unsecured, and a significant time may pass between when the lender advances the funds and when that student reaches their anticipated earnings potential.

In addition, because the Government does not guarantee private student loans as it does Federal student loans, many lenders require cosigners to help ensure repayment.

Notwithstanding the challenges of private student lending, we expect national bank and thrift lenders to provide flexibility to borrowers when appropriate. For example, lenders typically defer payments while borrowers are in school and offer grace periods afterward to help borrowers transition to employment. Student loans are the only consumer product with such a transition period. This flexibility reflects the unique circumstances of the student borrower and that these loans truly are an investment in the borrower's future.

We also encourage lenders to work with borrowers who experience financial hardship. That assistance may come in the form of forbearance, modification programs that reduce interest rates or change other terms of the original loan, or extended grace periods that go beyond what is permitted in other consumer loans for up to 12 months. The OCC supports these efforts and issued guidance to our examiners in 2010 describing our expectations for managing forbearance, workout, and modification programs.

While the OCC encourages national banks and thrifts to work with borrowers facing difficulties, this does not relieve these institutions of their responsibility to ensure that regulatory reports and financial statements are accurate and representative of the financial condition of the institution. Neither the public nor the banking industry should confuse the expectation for full and accurate reporting as a limit on available forbearance, workout, and modification programs.

To be clear, our Student Lending Guidance allows flexibility for lenders to offer forbearance and modification programs, but requires banks to report the volume and nature of these transactions accurately. The flexibility to assist borrowers and the responsibility to report these actions accurately are not mutually exclusive. Together they promote a safe and sound banking system.

My testimony concludes with a discussion of a number of policy recommendations to strengthen student lending. Overall, the OCC supports recommendations aimed at improving the transparency of student loans to help students and their families make better informed decisions. Likewise, we support loan documents and billing statements that are easy to read and understand.

In closing, while private student lending is a small part of the available financial assistance in this country, it is an important part, and we encourage banks to work with troubled borrowers during periods of hardship.

Thank you for the opportunity to testify, and I would be happy to answer your questions.

Chairman JOHNSON. Thank you, Mr. Lyons.

Mr. Vermilyea, please proceed.

STATEMENT OF TODD VERMILYEA, SENIOR ASSOCIATE DIRECTOR, DIVISION OF BANKING SUPERVISION AND REGULATION, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Mr. VERMILYEA. Chairman Johnson, Ranking Member Crapo, and other Members of the Committee, thank you for the opportunity to testify at today's hearing. First, I will discuss recent student loan market trends and the portfolio performance of both Government-guaranteed and private student loans. I will then address the Federal Reserve's approach to supervising financial institutions engaged in student lending.

The student loan market has increased significantly over the past several years, with outstanding student loan debt almost doubling since 2007 from about $550 billion to over $1 trillion today. Balances of student loan debt are now greater than any other consumer loan product with the exception of residential mortgages, and this is the only form of household debt that has continued to rise during the financial crisis.

Since 2004, both the number of borrowers and the average balance per borrower has steadily increased. In 2004, the share of 25-year-olds with student debt was just over 25 percent, and it stands at more than 40 percent today. At the end of 2012, the average balance per borrower was slightly less than $25,000 compared with an average balance of just over $15,000 in 2004.

Of total student debt outstanding, approximately 85 percent is Government-guaranteed in some way while private loans represent 15 percent of the market. While Federal student loan originations have continued to increase in each year, private loan originations peaked in 2008 at roughly $25 billion and have dropped sharply to just over $8 billion in 2012.

In line with the rapid growth in student loans outstanding, the balance of student loans, private and guaranteed, that are currently delinquent has risen sharply, standing at 11.7 percent in 2012, a large increase from 6.3 percent in 2004. However, some 44 percent of balances are not yet in their repayment period, and if these loans are excluded from the data pool, the effective delinquency rate of loans in repayment roughly doubles to 21 percent.

Of the $1 trillion in total outstanding student loan debt, about $150 billion consists of private student loans. In the private student loan market, roughly 5 percent, or $8 billion, is delinquent. There are likely a number of factors underlying the difference in performance of Government-guaranteed and private student loans. For instance, underwriting standards in the private student loan market have tightened considerably since the financial crisis, and today almost 90 percent of these loans have a guarantor or cosigner.

The Federal Reserve has no direct role in setting the terms of student loan programs. The Federal Reserve does, however, have a window into the student loan market through our supervisory role over some of the banking organizations that participate in this market.

Federal Reserve supervision of participants in the student loan market is similar to our supervision of other retail credit markets and products. For large institutions, the Federal Reserve regulates with significant student loan portfolios, our onsite examiners evaluate institutions' credit risk management practices, including adherence to sound underwriting standards, timely recognition of loan deterioration, and appropriate loan loss provisioning.

The Federal Reserve and other Federal banking agencies have jointly developed guidance outlining loan modification procedures that discusses how banks should engage in extension, deferrals, renewals, and rewrites of closed and retail credit loans, which include student loans.

Any loan restructuring should be based on a renewed willingness and ability to repay and be consistent with an institution's sound internal policies. The Federal Reserve encourages its regulated institutions to work constructively with borrowers who have a legitimate claim of hardship. Moreover, Federal Reserve examiners will not criticize institutions that engage in prudent loan modifications but, rather, view modifications as a positive action when they mitigate credit risk.

As supervisors, our goal is to make sure that lenders work with borrowers having temporary difficulties in a way that does not contradict principles of sound bank risk management, including reflecting the true quality and delinquency status of student loan portfolios.

Higher education plays an important role in improving the skill level of American workers. Due to increases in enrollment and the rising costs of higher education, student loans play an important role in financing higher education. The rapidly increasing burden of student loan debt underscores the importance of today's hearing.

This concludes my prepared remarks, and I would be happy to answer any questions you have.

Chairman JOHNSON. Thank you, Mr. Vermilyea.

Ms. Eberley, please proceed.

STATEMENT OF DOREEN R. EBERLEY, DIRECTOR OF RISK MANAGEMENT SUPERVISION, FEDERAL DEPOSIT INSURANCE CORPORATION

Ms. EBERLEY. Chairman Johnson, Ranking Member Crapo, and Members of the Committee, thank you for the opportunity to testify on behalf of the FDIC on the important topic of private student loans.

In today's fragile economic environment, with persistently high levels of unemployment and underemployment, many consumers are struggling with debt loads from student loans, both Federal and private. We understand the concerns of struggling private student loan borrowers and encourage the banks we supervise to work constructively with these borrowers.

While it is difficult to be precise about the size of the private student loan market, it is estimated that, as of December 31, 2011, the market totaled about $150 billion, or 15 percent of all student loans outstanding. In the 2011–12 academic year, banks supervised by the FDIC held about $14 billion in outstanding private student loans and originated about $4 billion in new loans.

The FDIC supervises private student loan lenders using the same framework of safety and soundness and consumer protection rules, policies, and guidance as for other loan categories. The interagency Uniform Retail Credit Classification and Account Management Policy, or Retail Credit Policy for short, applies to student loans as it does to other unsecured personal loans. This policy provides institutions with guidance on classifying retail credits for regulatory purposes and on establishing policies for working with borrowers experiencing problems.

Private student loans held by FDIC-supervised institutions are generally performing satisfactorily. They have a past-due ratio of just under 3 percent and a charge-off rate of just over 1.5 percent per year. While the overall performance of these private student loans is satisfactory, we understand that many borrowers are currently having difficulty repaying their loans, and we encourage the banks we supervise to work with troubled borrowers using the guidance provided by the Retail Credit Policy.

The Retail Credit Policy provides institutions flexibility in offering prudent loan modifications. Institutions are responsible for establishing their own modification standards within the principles set forth within the Retail Credit Policy. They must also monitor the performance of modified loans to ensure that their standards are reasonable. We make clear to our institutions that we will not criticize banks for engaging in alternate repayment plans or modifications that are consistent with safe and sound practices. In the end, prudent workout arrangements are in the long-term best interest of both the financial institution and the borrower.

Under the policies they established, FDIC-supervised banks offer troubled borrowers forbearance for periods ranging from 3 to 9 months beyond the initial 6-month grace period after leaving school. In addition, a number of workout plans are also available to borrowers of institutions we supervise, including interest rate reductions, extended loan terms, and in settlement situations, principal forgiveness.

However, it is important that workout programs not leave the borrower worse off. For example, a workout that results in significant negative amortization can leave a borrower deeper in debt.

Concerns have been raised that troubled debt restructuring accounting rules, or TDR rules, limit a bank's ability to modify student loans. The TDR rules are established by generally accepted accounting principles, which banks are required by law to follow. However, the TDR rules do not prevent institutions from working with borrowers to restructure loans with reasonable terms. The FDIC will not criticize a restructured loan even if it is designated a TDR.

We also appreciate the significant challenges borrowers face for refinancing higher-rate private student loans. One of the more important challenges is the lack of participants in the refinance market.

The FDIC continues to seek solutions for challenges in the student lending arena. In the new few weeks, we intend to issue a financial institution letter to the banks we supervise clarifying and reinforcing that we support efforts by banks to work with student loan borrowers and that our current regulatory guidance permits this activity. The financial institution letter will make clear that banks should be transparent in their dealings with borrowers and make certain that borrowers are aware of the availability of workout programs and associated eligibility criteria.

We have also formed an internal work group to engage private student loan lenders and consumer groups on these issues. We are discussing our current policies and the refinancing challenges with other regulators to determine whether additional clarifications or changes of current policies may be needed.

Thank you again for inviting me to testify. I look forward to your questions.

Chairman JOHNSON. Thank you, Ms. Eberley, and thank you all very much for your testimony.

As we begin questions, I will ask the clerk to put 5 minutes on the clock for each Member.

This question is for the whole panel. If Congress fails to act, interest rates will double on some Federal Stafford loans next week. If these rates double, what do you think the impact will be on the private student loan market? What steps are your agencies taking to closely monitor the situation and any related growth in the private student lending market? Mr. Chopra, let us begin with you.

Mr. CHOPRA. Well, the data in the Federal student loan interest rates only impacts future borrowers, so it has absolutely no impact on private student loan borrowers who are currently trying to refinance to pay back those loans.

Some industry observers would guess that the change in the interest rates might be a slight tail wind to private loan origination, but I do not expect it to be a huge one.

Chairman JOHNSON. Mr. Lyons.

Mr. LYONS. I think what you may see in the private loan market is risk-based pricing, which is what they should be doing today, and I think you should see that continuing forward. It all is predicated on the competition within the market and with the competitors of pricing as well.

Chairman JOHNSON. Mr. Vermilyea.

Mr. VERMILYEA. If pricing in the Government space were to increase, we would expect that the relative attractiveness of the price of products would increase, so we would expect growth in new originations. Our examiners would monitor this. They would monitor underwriting standards. As the importance of the asset class increased, their scrutiny of it would increase commensurately.

Chairman JOHNSON. And, Ms. Eberley?

Ms. EBERLEY. I think that there would definitely be an impact on borrowers in the Federal program going forward, as Mr. Chopra noted, with the increase in interest rates. But the impact on the private market I think is really unclear. As noted by Mr. Lyons, the private market does engage in risk-based pricing, and so the pricing of the Federal loan product is not really a factor in the private loan product.

I would add that I would expect that students would continue to try to exhaust Federal loans first before moving to private loans just because of the available options under the Federal loan program for repayment and rehabilitation in particular that are not available under the private program.

Chairman JOHNSON. Mr. Lyons, followed by Mr. Vermilyea and Ms. Eberley, the agencies do not have public guidance tailored to private student lending, instead relying on an interagency policy on retail credit that was last updated over 13 years ago. Some have suggested that this guidance prevent private lenders from granting appropriate relief to struggling borrowers.

What flexibility do lenders have in working with borrowers to prevent default? And what additional steps will your agencies take to provide clear, up-to-date loan workout guidance for private student lenders? Mr. Lyons.

Mr. LYONS. Senator, the interagency guidance, as you said, was prepared 13 years ago. The OCC in 2010 provided some additional guidance to our examiners addressing forbearance, workout programs, and so on, and it was really driven by the fact that banks were not properly recording transactions, workout transactions and forbearance transactions on their books. So we provided examiners with clarification and further guidance, and as I said, that was in 2010.

Having said that, we continue to encourage banks to work with customers. There is nothing in the guidance, either the uniform retail guidance or the OCC guidance, that prevents a bank from working with a customer. The bank, however, does have the responsibility of properly recording that transaction on their books.

Chairman JOHNSON. Mr. Vermilyea, do you have anything to add?

Mr. VERMILYEA. The retail loan guidance is very broad in nature and articulates timeless principles of risk management. It is not a prescriptive piece of guidance. It does not declare certain types of things out of bounds, but instead encourages banks to work with their borrowers when they can reaffirm the ability and willingness of the borrower to repay.

Chairman JOHNSON. Ms. Eberley.

Ms. EBERLEY. I believe that the Retail Credit Policy guidance does offer institutions the flexibility to work with borrowers, and, in fact, the institutions that the FDIC supervises have used that flexibility and offer a range of workout programs. The one that I highlighted earlier was a differing range of forbearance after the initial 6-month grace period. Forbearance periods range from 3 to 9 months in the institutions we supervise.

So we have not set forth anything concrete or prescriptive, but our institutions are using the flexibility and the guidance in the way that it was intended.

Chairman JOHNSON. Senator Crapo.

Senator CRAPO. Thank you, Mr. Chairman.

Mr. Chopra, last month, the Bureau published a report on the effects of student debt on young people's economic futures, and in that report you make several policy recommendations, including spurring a more robust refinancing market, offering more relief options, and a possible credit report clean slate program. It is my understanding that some of these proposals may require legislative changes.

Have you heard from the lenders and the regulators about the merits of these programs? And do you believe that the lenders currently have the tools and legal authority to participate in these programs?

Mr. CHOPRA. Well, all of those suggestions that we put forth in the report were a summary of public comments that we received, and many of them, in fact, would not require legislation.

In order to maximize the value of a troubled loan portfolio, banks and other financial institutions generally go through the process of identifying interventions that would increase the net present value of those loans. As the other panelists have mentioned, restructuring those loans is something where safety and soundness as well as helping borrowers seem to go hand in hand, and I share the concern of many investors, both equity and debt, who would like to see financial institutions maximize the value of these portfolios. It also ensures that those customers become lifelong loyal customers and can continue to bank with that institution by borrowing mortgages, auto loans, and other things that may provide higher net income to that institution.

Senator CRAPO. Thank you. And for the other regulators, I have heard from many lenders that they are willing to offer more relief options. However, if the lender does modify a student loan, then they have to account properly for modifications on their books under the GAAP accounting standards. And a high number of modifications could signal to the prudential banking regulators that the lender's loan portfolio is not safe or sound.

Thus, we have a situation in which the CFPB is advocating for certain relief options that may not be possible under current guidance and prudential banking regulations.

First of all, is that correct? And how can lenders offer loan modifications without running afoul of the safety and soundness and accounting standards that they now must qualify under or must pursue? Mr. Lyons.

Mr. LYONS. Senator, we encourage banks to work with customers when they have financial hardships. That would be reflected in the portfolio regardless of whether they did that or not. So whether it was a TDR or not, you would probably have a past due loan and a delinquent loan, so the risk would still be identified in the portfolio. We encourage banks to work with customers before they get to the point where it is severely delinquent.

Banks do have the flexibility of offering a number of different programs, but as we did say, they are responsible for accurately reporting those transactions on their balance sheet. They have a fiduciary responsibility to their depositors, investors, and shareholders that they accurately report the risk profile of those portfolios.

Senator CRAPO. Thank you.

Mr. Vermilyea?

Mr. VERMILYEA. So very similar, we expect our banks to work with borrowers in a way that benefits both the bank and the borrower. A restructured loan that is performing is far better for everyone than a severely delinquent loan or a charge-off.

We also expect banks to follow basic principles of sound risk management. Typically, for a bank that has a large portfolio of restructured loans, we would expect them to segregate these loans from others on their balance sheet and then monitor the risk characteristics of this portfolio, understand the probability of default, understand the loss given default, and then hold appropriate reserves and capital.

If a bank could demonstrate with their data that these loans performed in the same way as past credits, then that would be a perfectly appropriate outcome. But we always expect banks to follow accounting guidelines as well.

Senator CRAPO. Thank you.

Ms. Eberley?

Ms. EBERLEY. I would agree with everything my fellow panelists have said, that, you know, when you have a troubled debt restructuring, you by definition have a troubled debt to begin with. So the actual accounting designation of a TDR really does not impact the examiner's view of whether or not the debt was troubled to begin with. It does impact the examiner's view about the bank's ability to work with that borrower and turn a problem situation into a better situation. By definition, a troubled debt restructuring indicates that the bank is working with the borrower, taking a bad situation and trying to find a way out.

It is important that our examiners do take a look on the back end, as Mr. Vermilyea noted, of an institution's results with their troubled debt restructurings, with their modifications, to make sure that modification programs are reasonable and are ending up in a result that is good for both the consumer and the bank.

Senator CRAPO. Thank you.

Thank you, Mr. Chairman.

Chairman JOHNSON. Senator Reed.

Senator REED. Thank you very much, Mr. Chairman.

Mr. Chopra, you are responsible for coordinating with the Department of Education, and also you are responsible for reviewing the servicers—is that correct—the people who are servicing these loans?

Mr. CHOPRA. Yes. The Bureau has a number of initiatives with the Department of Education and has supervisory authority over large financial institutions over $10 billion in assets for consumer financial laws with servicing operations. In addition, we have proposed supervision of certain large nonbank servicers.

Senator REED. Well, let me ask you a question. To what extent are these loans held by servicers in sort of trust arrangements, as was common with mortgage securities, or held directly by financial institutions so that they can, in fact, negotiate with their customer directly?

Mr. CHOPRA. As for private student loans, I would say roughly half are held in ABS trusts where there is a master servicer and appropriate guidelines, and governing those changes to the notes would apply. A key difference between subprime mortgage MBS or private student loan ABS is that it appears that the servicers, generally speaking, have more discretion relatively speaking in the mortgage world to conducting certain interventions that may maximize the value for those debt investors.

Senator REED. Are they taking those advantages from your perspective now as you get ready to regulate them?

Mr. CHOPRA. Well, our oversight solely relates to consumer financial laws. There is certainly activity to restructure certain loans with certain players that service asset-based securities whose underlying assets are private student loans. But I think, in general, the activity of modifying or restructuring debt that may be in the best interest of the debt investor and the borrower is troublingly low.

Senator REED. Troublingly low. Thank you.

Mr. Lyons, do you supervise both the banks and the servicers that are part of the holding companies you supervise? How does that——

Mr. LYONS. Well, if it is connected in a national bank, we do supervise a national bank's activities, whether it is on the bank's books or if it is being serviced by the national bank. We will look at that activity as well.

Senator REED. And is it common for banks to maintain a loan on their books as performing because they hope ultimately to collect something since these loans are not dischargeable in bankruptcy?

Mr. LYONS. Student loans are not dischargeable in bankruptcy. That does not mean that the bank should not under certain circumstances show impairment or charge that loan off if it is not performing.

Senator REED. But do they routinely show impairment or do they assume that, one, they will collect eventually? Under accounting rules can they——

Mr. LYONS. Under accounting rules that we enforce, we expect the bank to show impairments and to take charge-offs when they become past due, over 120 days, regardless of whether or not there is——

Senator REED. And what is the general record of impairment of student loans today in the institutions you supervise? High? Low?

Mr. LYONS. There are eight national banks that conduct private student lending. Each one of those banks has engaged in some type of workout or forbearance. The number is not very large. The performance in those portfolios has been pretty good. As we said earlier, the past due rates are generally in the 3- to 4-percent range, and the loss rates are generally 4, 4.5 percent. So the performance has been relatively good.

Senator REED. That is of this vintage loans——

Mr. LYONS. That is the entire portfolio, so that would cover all vintages.

Senator REED. OK. And is there any difference between those loans held by the institution and those held by a servicer affiliate of the institution?

Mr. LYONS. I am not sure what the servicer portfolios delinquency rates are. What I quoted you was what is on the book.

Senator REED. Mr. Vermilyea, how about the servicer portfolio? Since the holding company—there would presumably be a holding company subsidiary. Are you noticing high levels of default or high levels of modification?

Mr. VERMILYEA. Well, the data that we have is very similar to that cited by our colleague from the OCC. We do not have data that distinguishes the delinquency and default rate for loans where the servicer is separate. We can follow up on that.

Senator REED. Please do so. But, again, I just want to confirm, Mr. Chopra, from your perspective, your point was that you are not seeing the kind of modifications numbers that would follow from the loan crisis that you are seeing in terms of delinquencies. Is that a fair statement? I do not want to——

Mr. CHOPRA. There are, of course, usages of forbearances, as the other panelists have mentioned, but I do not think there is a significant amount of concessions given by lenders, where they appropriately note them in their accounting statements and then modify the loan. It is a very low volume.

Senator REED. Thank you.

Chairman JOHNSON. Senator Warren.

Senator WARREN. Thank you, Mr. Chairman.

As we have seen in recent studies and as some of our witnesses have testified today, private student loans carry high interest rates, they are difficult to restructure, and in many cases, they have created a barrier for people trying to buy their first homes. That is why I was surprised that a Federal Home Loan Bank has been making available an $8.5 billion line of credit to the Nation's largest private student loan company, Sallie Mae.

The Federal Home Loan Banks were established to expand homeownership, but now it seems that they are undermining that goal by helping finance more student loan debt. In addition, the Federal Home Loan Banks get extraordinarily cheap access to capital thanks to Government sponsorship, and that cheap capital was provided to Sallie Mae. And let us be specific on this. Sallie Mae has been getting this line of credit for one-third of 1 percent interest, and then turning around and lending money to students at a rate about 20 times higher than that.

So yesterday I sent a letter to FHFA Acting Director Ed DeMarco because he regulates the Federal Home Loan Banks, but you are all experts, so I want to ask you about this, too. Does it make any sense for a Fortune 500 company that makes high-profit student loans to be able to borrow money for less than one-third of 1 percent from a program that has Federal backing for homeownership? Mr. Lyons, how about if we start with you?

Mr. LYONS. Senator, the OCC does not regulate Sallie Mae so——

Senator WARREN. I understand that. I understand that.

Mr. LYONS. I am not familiar with that program.

Senator WARREN. But I am asking you the fundamental question. They are getting money at a third of 1 percent.

Mr. LYONS. Right.

Senator WARREN. And then turning around and lending it to students at many multiples of that.

Mr. LYONS. Senator, can I please speak to national banks? The rates that the national banks are charging for private student loans today are comparable to what are being charged for Federal loans. So there is a spread there. National banks are offering rates LIBOR-plus, relatively the same as Federal loans. So they are offering in the neighborhood——

Senator WARREN. So you are telling me it is like Federal loans, which this year will make $51 billion in profits for the Federal Government. I am not sure I find that reassuring.

Ms. Eberley, do you have any comment on the question about the Federal Home Loan Bank Board's lending to Sallie Mae at a third of 1 percent?

Ms. EBERLEY. So I think the issue you are raising is a public policy issue. The Federal Home Loan Bank is authorized to make loans that are secured by the former Federal loan program collateral, so loans that were issued by institutions with a Federal guarantee. So that is allowed under——

Senator WARREN. I am not asking the question whether or not they behaved illegally. I am really asking the question if they are there to promote homeownership. I think we have heard from our witnesses today that homeownership may be undermined, that there is data suggesting that homeownership is undermined by the growing amount of student loan debt. And so I see the Federal Home Loan Bank Board seems to be heading in opposite directions at the same time.

Mr. Chopra, do you have any comment on this?

Mr. CHOPRA. I have no idea as to why——

Senator WARREN. Hit your button.

Mr. CHOPRA. Oh, I am sorry. I have no idea about the appropriateness of that arrangement. It is true, though, that data would suggest that student loan borrowers are now less likely to have a mortgage.

Senator WARREN. All right. Well, that is a helpful point in it, but really worrisome about the policy that we are following here.

Let me ask another question. I understand when we first started why we called student loans "subsidized." But this year, the Government will profit $51 billion from the student loan program. The new loans will make a profit of $184 billion over the next 10 years. And it turns out that even the so-called subsidized loans make a profit of about 14 cents on the dollar. The student interest rate is scheduled to double July 1st, and so the question I have is: Why do we call these loans "subsidized"? I do not get this. Why are they called "subsidized"? Mr. Lyons?

Mr. LYONS. Senator, you are referring to the Federal program that national banks do not lend into. They lend into the private market, so I would be happy to discuss the private market.

Senator WARREN. I take that as a no.

Mr. Chopra?

Mr. CHOPRA. Well, the reason that it is called "subsidized" is because in the old bank-based program, where they gave Federal loans that were guaranteed, the Government paid subsidies to the financial institutions for interest accrued during periods such as being in school.

Senator WARREN. Are we doing that anymore?

Mr. CHOPRA. No. That program has ended.

Senator WARREN. No. So we call these "subsidized" loans even though today the program has been completely changed and, in fact, is making a profit for the U.S. Government.

I just want to say, you know, this just seems wrong to me, Mr. Chairman. The Government lends to banks at three-quarters of 1 percent interest, then does a huge markup on student loans, and will make $51 billion in profits this year. Sallie Mae borrows at one-third of 1 percent in a program that is supported by the Federal Government and then does a markup on student loans. It is time for the Government to stop making a profit off our students.

Thank you, Mr. Chairman.

Chairman JOHNSON. Senator Brown.

Senator BROWN. Thank you, Mr. Chairman.

Mr. Chopra, give me your thoughts on our REFI for the Future Act, in answering some of the questions and concerns on the $150 billion outstanding, and for the future, what this means for private bank loans.

Mr. CHOPRA. So without knowing specifics, I can say that it is absolutely important that we address the large population of existing borrowers and not just the new borrowers. Many of those existing borrowers were certainly victims of a financial crisis that they played no role in creating, and they wonder why they have been unable to take advantage of today's historically low rates. And just as in 2008, there were market failures that provided for temporary authorities to ensure financial institutions could originate loans, but there are no authorities currently to jump-start that sort of market. So it seems that it is worthy of very careful consideration.

Senator BROWN. Thank you. This is for all of you. Student loan debt, as a number of people have pointed out, Senator Crapo and the Chair and others, is the second largest form of consumer debt behind mortgages. And I see some similarities between these two issues, these two lending institutions in some sense, if you will. The biggest banks we hear repeatedly, finding out more information last week, are doing a generally poor job complying with the national settlement over their improper foreclosure practices. Homeowners have had some of the same problems that responsible student loan borrowers are having. They cannot refinance, they cannot negotiate a deal for an alternative repayment arrangement with the institution with whom they have their mortgage. But some large financial institutions are at least trying to pursue some mortgage modifications to stem their losses. But with the student loan market, it does not seem like that refinancing is happening, with very, very, very few exceptions. Despite the Federal Reserve's testimony that student loan modifications are generally in the best interest of both the institution and the borrower, can lead to better loan performance, increased recoveries, reduce credit risks, and that they will view such modifications as a positive action when they mitigate credit risk.

So even though the regulatory bodies are saying this makes sense for banks to begin to refinance some of this $150 billion in outstanding student debt, why—I understand this is a small portfolio for Citibank or for some of these large institutions—the student loan market is not very large, relatively, for them. But each of you answer, why are the banks not willing—when regulators are saying this makes sense, when common sense suggests that this makes sense to refinance, why are the large banks simply not coming to the table to refinance these student loans? I will start with you, Ms. Eberley.

Ms. EBERLEY. Certainly. It is a good question why there is not an active refinance market for student debt. There is nothing in regulatory policy or practice that prohibits borrowers from refinancing their student debt. None of the institutions that FDIC supervises uses prepayment penalties or anything that would prevent a borrower from actually engaging in a refinance. Part of it may be that the interest rates relative to other unsecured consumer debt available through banks is actually priced a little higher than student debt is, so that may be one factor.

The underwriting criteria used by the institutions that FDIC supervises usually requires a guarantor, which means the debt is underwritten at a rate that reflects that you have already got an established borrower listed on the debt. So you may be starting out with a low rate to begin with based on that established credit history as opposed to a student on their own. So that does not address any legacy loans that are outstanding, that are at higher rates of interest, or that were not cosigned. You know, so it is unclear why there is not an active market to meet apparent demand. So I think the proposal is very interesting, and that is something we would be interested in working with you on.

Senator BROWN. Mr. Vermilyea, this issue of too big to fail with these largest banks, it is coming back again. Is this sort of a too big to care sort of situation with these large banks with a relatively smaller portfolio, they are just sort of disdainful of doing anything with refinancing student loans?

Mr. VERMILYEA. I do not think it is too big to care. I think they are interested in profit opportunities where they can find them. I would associate myself with the response from the FDIC. It is not clear why this is not happening more. Our regulatory policy would certainly permit it, indeed encourage appropriate workouts. So like the FDIC, we are interested in exploring this further.

Senator BROWN. Mr. Lyons.

Mr. LYONS. Senator, I would echo the comments of my fellow regulators. I think also it may reflect some market inefficiencies like competition as well. As Ms. Eberley said, many of the student loans, private student loans today, are priced off of a cosigner, so they are actually at a lower rate than would normally be the situation. So, that may also factor into why we are seeing low refinancing opportunities.

Senator BROWN. Mr. Chopra.

Mr. CHOPRA. Well, as you mentioned, net income from private student loans is a very small fraction for large financial institutions. As we note in our report, many of those financial institutions' senior management are still addressing legacy issues of troubled portfolios, particularly in the residential mortgage space, that may be occupying significant management bandwidth, including issues with the flexibility and agility with their IT and accounting systems.

Senator BROWN. All right. Mr. Chopra, your comments earlier about, you know, establishing—what puzzles me further about this that you mentioned earlier was that these institutions that are simply not—that seem indifferent to if not hostile to refinancing are the same institutions that I would think would want these young people to whom they lend this money to be lifelong customers and get a mortgage someday when they can pay off their student loans and start businesses and all the things—and use these banks with whom they have a relationship. But that does not seem to be the case.

Thank you, Mr. Chairman.

Chairman JOHNSON. Senator Merkley.

Senator MERKLEY. Thank you, Mr. Chair, and I am going to start by addressing something. As we were sitting here, the Supreme Court released a ruling eviscerating the Voting Rights Act, and I am deeply disturbed about that. The strategy of voter suppression has been used against blacks, Latinos, elderly, the poor, immigrants. We had a situation in our history where New York City politicians held registration days on Jewish holidays to keep Jewish individuals from voting. We have had all kinds of forms of efforts to not embrace the full ability of citizens to participate in our democracy. And today we have strategies that include voter ID laws, the reduction of early voting hours, the drawing of discriminatory districts, and so we are not in an era free of a strategy to block people's ability to participate as full citizens, and I think it is deeply disturbing, the 5–4 decision that just came out is deeply disturbing.

The topic we are addressing right now on the cost of student loans, it seems like we have a new form of debtor's prison for our students because the loans, in combination with interest rates, mean individuals are having to delay living independently, delay marriage, cannot get a loan to buy a house, or if they do, their credit score, because of the debt that they carry, is lower so they have to pay a lot more in interest to buy a home. They cannot get a loan to start a business. They may be disadvantaged in employment interviews. All of these are factors that compromise one's ability to thrive.

And one of the pieces that is disturbing to me is these private loans vary their interest rates according to the credit background of the applicant even though the loans are guaranteed, which means that if you come from a background in which you have less wealth, you are going to pay a higher price over a very long period of time to get an education, thus locking in inequities from one generation to the next.

Are any of you disturbed by that bias in the system? And if so, what do you think we should do? Doreen, or Ms. Eberley, perhaps we can start with you.

Ms. EBERLEY. So I may have misunderstood the question, but the private student loans that we have supervisory responsibility for, the lenders that make those loans, those loans share a similarity with Federal student loans in that they are not dischargeable in bankruptcy, but they are not guaranteed by the Government. So that is a key distinction. So the institutions bear the risk of loss for a default on those loans.

Institutions are offering—the institutions that we supervise are offering a choice of either a variable or a fixed rate of interest at the onset of the lending agreement. So the current variable rate of interest ranges between 3 and 9 percent, the fixed rate between about 5.5 and 11.5.

Senator MERKLEY. Is it fair to say someone from a background where they have less wealth, less assets, is more likely to pay the 9 percent than the 3 percent and, therefore, pay a much higher price for their education?

Ms. EBERLEY. So it is true that an individual that had a less strong credit history would pay a higher rate of interest.

Senator MERKLEY. So yes. The answer is yes?

Ms. EBERLEY. It is risk-based, yes, based on the individual's credit history——

Senator MERKLEY. I take your point on the national guarantee and thank you for pointing that out.

Does this bother anyone else?

Mr. CHOPRA. Well, Senator Merkley, the private student loans are often underwritten to the FICO score and income of a cosigner. So for borrowers whose parent, say, is not very creditworthy, they, in fact, would have a higher rate when they were freshmen. I think that many of them wonder, once they do graduate and land a very good job, they wonder that given their risk profile may have considerably shrunk, they have developed their own credit history, why they are unable to find a product in the market that is a lower risk-adjusted price.

Senator MERKLEY. And they wonder about that because they are not able to refinance?

Mr. CHOPRA. That is right. And I think many of them see the incredible savings that perhaps their parents, who may be homeowners and have been able to refinance given today's historically low interest rates, have been able to take advantage of.

Senator MERKLEY. Does the system in general, as we have described it here, create extra hurdles for those who come to the education marketplace with poor assets?

Mr. CHOPRA. Well, there are certainly issues with market efficiency when price does not seem to match risk, which seems to be an issue.

Senator MERKLEY. Mr. Lyons, is there kind of a bias that reinforces differences in background?

Mr. LYONS. Senator, I do not know that answer. I would echo what Doreen Eberley indicated, that we expect banks to risk-price. They do risk-price. To the extent a student utilizes all of his Federal grants and loans and then has to move to a student loan, a private student loan, that loan would be risk-base priced.

Senator MERKLEY. If you have a loan that is 9 percent versus one that is 3 percent, would it be fair to say that by and large the cost of the loan is going to be 3 times as high?

Mr. LYONS. Not necessarily 3 times, but it will be more expensive, yes.

Senator MERKLEY. The interest rate will be 3 times as high.

Mr. LYONS. Yes, the interest rate is 3 times as high.

Senator MERKLEY. And, thus, a low-income student, a student with parents who are cosigning who have a poor credit record might pay 3 times as much in interest over the course of the loan.

Mr. LYONS. To the extent it is a higher risk, the bank would charge a higher rate of return, yes.

Senator MERKLEY. Thank you.

Thank you, Mr. Chair.

Chairman JOHNSON. Senator Heitkamp.

Senator HEITKAMP. Thank you, Mr. Chairman.

Just a couple of points, and I do not remember if it was Mr. Lyons or Mr. Vermilyea who gave us the side-by-side comparison, 2004 to today. I think it was you. You might want to add another statistic to your record there. Fifty-five percent of all private loans in 2005 had a cosigner; today it is 90 percent. We are not only mortgaging our kids' future; we are mortgaging their parents' future, their grandparents' future, and we are putting their homeownership and their retirement at risk.

This is a big issue, the issue of cosigning, and so I just raise that because I think it is important to put that on the table.

A couple issues—one on transparency and one on a recent visit that I had in North Dakota where I had a chance to sit in the car and actually listen to the radio, and this is for Mr. Chopra. Have you seen the 1–800 numbers or heard the 1–800 numbers, "Get yourself out of student debt trouble. We are here to help"? They sound a lot like the predatory lending that we have experienced over the last how many years with home mortgages or consumer debt, credit card debt. And I see an entrance now or an opportunity to move into that market by people who are engaged in predatory lending practices, and I am wondering if you guys are monitoring that, paying attention, and if there is anything Congress should be doing right now, you to educate students but us to get out ahead of it on a regulatory basis.

Mr. CHOPRA. Well, we are certainly familiar with the increase in debt collection and debt relief activities as the conditions in the student loan market for many have been quite challenging. For borrowers who have Federal student loans, there are marketed services to pay a fee to enroll in certain programs that may help then get out of default through the Department of Education, which may be at no cost. So, of course, we are looking to educate consumers and ensure that all financial services providers are complying with the law.

Senator HEITKAMP. Just to follow up, one suggestion that I would have—and I know budgets are limited. But the ability to advertise on the same platform, to educate on the same platform, is critical, because what—they are not advertising to kids on, you know, 790 talk radio; they are advertising to those parents who have cosigned those loans. And that is a big concern that I have.

Mr. Lyons, you raised a very important point, I think, on transparency. Anyone recently has had a mortgage has sat down for almost an hour and a half and done all the due diligence, signed all of the, you know, awareness—"Yes, we know we are mortgaging away our life."

You know, frequently what happens to a kid and their parents on student loans is that the paper gets slid across the desk and sign on the bottom line if you want a better future. And for especially a lot of first-generation college-goers, you know, there is not maybe a level of sophistication on what the alternatives are.

And so I am wondering if anyone on the panel, but particularly you, Mr. Lyons, since you raised the issue, has some suggestions for what we can do to promote more transparency in the private marketplace and, you know, whether that should be mandated, encouraged, or otherwise, you know, talked about.

Mr. LYONS. Thank you, Senator. I would agree with the recommendations that the CFPB put forth regarding disclosure and clear transparency.

Senator HEITKAMP. But how do we get banks to do that?

Mr. LYONS. I think that banks have taken steps over the last several years since the crisis to improve transparency, and so there are discussions before, during, and after that they provide the students and the students' family; whereas, in the past that may not have been the case.

Senator HEITKAMP. All right. One thing I would suggest—and my time is short, and that is why I am interrupting, and I will follow up with some additional questions. But this needs to be done in conjunction with institutions of higher learning. I have a student right now in North Dakota who has $100,000 of private debt; he is a first-generation student; he is a music major, and he is living in his parents' basement. His parents, I am sure, are on the hook for that same level of debt. He will never retire that debt. He will never get out from underneath it. And we have guaranteed that by not discharging this debt in bankruptcy.

And so with a little bit of education about, you know, what that education is worth compared to the earning power into the future, and what we need to do to educate kids not only as they pursue their dreams, but taking a look at what the earning power is of the choices they make in terms of education opportunities. And so I think you are only one part of the problem—I would not say "problem," but you are only one part of the solution, which is here it is, financial literacy, but back it up with also education on what the earning potential is for these students, and maybe banks can be part of encouraging that as well.

Thank you, Mr. Chairman.

Chairman JOHNSON. Senator Manchin.

Senator MANCHIN. Thank you so much, Mr. Chairman.

We were talking about public policy, and I would like to get your input, since you are part of the public. I think you are hearing from all of us that we believe that education being—and the facts are overwhelming that education adds to the value of not only the person, their well-being, their families, their communities, their State, and the Nation. We all, I believe, have that agreement. We are all products of it probably.

With that being said, is it your opinion that we should not make a profit on education when it comes to loans? That is a public policy. We have got to make that. We need your input. So if I can just start with you, ma'am.

Ms. EBERLEY. Well, I am not sure if you are talking about in the Federal sector or the private sector.

Senator MANCHIN. I am talking about every—public policy, do you believe public policy should be that profits should not be made on education loans of any kind, so if we can just kind of pay itself and break even? Or do you put the same procedures and the same policies in place as you do any other type of loans?

Ms. EBERLEY. I think it is an interesting question, and I think you would have to differentiate between the Federal sector and the private sector in answering that question.

Senator MANCHIN. Not really.

Ms. EBERLEY. Well, in the private sector——

Senator MANCHIN. If it is public policy, it is public policy. So maybe your cost is a little different. Maybe your whole policy is a little different. But there is still a spread. There is a spread taking a lot of things in consideration. Do you believe that spread should be zero or minimized to the point to where there is no—I am just asking a simple question.

Ms. EBERLEY. Yes, I think it would be hard to calculate a zero spread on the private side just because the institutions bear the risk of loss, so that there is not the Government guarantee——

Senator MANCHIN. You do not have a public opinion then on——

Ms. EBERLEY. So I—you know, it is really not my area of expertise, and I——

Senator MANCHIN. You have an opinion. You are public. You have Representatives, Congress and the Senate. What would you say to your Congressman and Senator?

Ms. EBERLEY. You know, I would have to think about it. I have not thought through this.

Mr. VERMILYEA. In the private markets, we need to take many factors into consideration. One is credit availability.

Senator MANCHIN. I think the simple—I am just asking a simple public policy. Do you believe—here we sit. Do you believe that we should not make a profit if we can keep from making a profit on trying to educate this great society of ours?

Mr. VERMILYEA. My concern would be that if there were a mandated zero spread, for example, that there may not be credit availability in the public——

Senator MANCHIN. So you are saying that basically in the public—private sector that the almighty profit on every aspect of life is going to prevail? I am just—I am not—I am a private business person. I am just saying you have to put your priorities where your values are. If education is what has built this country, education has—this is the greatest country on Earth, how do we get there? And have we left that premise? And is everything the almighty dollar, the bottom line, to the point where we are trying to educate the masses? It is a public policy. You are talking—I am your Senator. What do you want me to do?

Mr. VERMILYEA. Education policy is not in the realm of the Federal Reserve, and the Governors have not spoken on this issue, so this is a matter for Congress.

Senator MANCHIN. OK. Now you know why we have a stalemate in Congress now, because we cannot even get the public to engage. That is—and I know you are looking, and you have to be careful what you are saying. I am just trying to get input. Sir?

Mr. LYONS. Well, I am not going to expand the discussion must further, Senator. I do not think it is appropriate for a prudential regulator to take a public policy position.

Having said that, I think I would echo what the two other regulators indicated, that it would be difficult to attract capital to a business that does not provide some profit to the investors. Just a consideration.

Senator MANCHIN. And you think that basically the American public and the investors in American society would not invest in education knowing that it would be a zero return?

Mr. LYONS. I think that is a possibility that has to be weighed.

Senator MANCHIN. OK. Mr. Chopra?

Mr. CHOPRA. Well, Senator, I agree with others that investors will not be able to earn a return on equity if they cannot earn any margin. But as it relates to your general question of profitability, the only thing I can add is there is data from a number of sources that does suggest there are positive externalities of a highly educated workforce in the sense of global competition, wage growth, and others, and certainly policymakers may consider that when developing policies to promote a highly educated workforce.

Senator MANCHIN. I am talking—primary and secondary education were mandated by the Constitution and most every State to subsidize and pay for, which I agree wholeheartedly. And we all do that willingly. Higher education, there is not a word in the Constitution in West Virginia that we have to give a penny toward that. So our Founding Fathers a long time ago thought this was a high-value, good return, and we got involved. And we do.

We are talking about a financial program that does not cost—we are not subsidizing. We are not asking someone to pay. It will pay for itself. Should we remove the profit where possible? And I think that is what Senator Warren and all of us—now, can we find that balance somewhere so that we can all be satisfied but you can still have enough money that we can keep the program alive, but we still have taken the amount of profit out that puts the burden on the backs of productivity? I think that is it in a nutshell, and that is where we are coming to, and we have got to—since we are not getting much help from the input from our constituents, we have got to be able to cipher through this one to find the balance between our colleagues on both sides of the aisle.

Thank you, Mr. Chairman.

Chairman JOHNSON. I want to thank our witnesses for their testimony today and for their hard work on this important issue.

This hearing is adjourned.

[Whereupon, at 11:28 a.m., the hearing was adjourned.]

[Prepared statements, responses to written questions, and additional material supplied for the record follow:]

PREPARED STATEMENT OF ROHIT CHOPRA

ASSISTANT DIRECTOR AND STUDENT LOAN OMBUDSMAN
CONSUMER FINANCIAL PROTECTION BUREAU

JUNE 25, 2013

Chairman Johnson, Ranking Member Crapo, Members of the Committee, thank you for the opportunity to testify today about student debt.

My name is Rohit Chopra, and I serve as an Assistant Director at the Consumer Financial Protection Bureau (Bureau). In October 2011, I was also designated by the Secretary of the Treasury as the Student Loan Ombudsman within the Consumer Financial Protection Bureau, a new role established by Congress in the Dodd-Frank Wall Street Reform and Consumer Protection Act.

By holding today's hearing, it is clear that many of you are keenly interested in finding solutions for some of the troubling trends in the student loan market. Since the Bureau and others began raising concerns about these trends, several monitors of the financial system have expressed worry about how student debt could impact the housing market and other parts of the economy.[1]

The increasing level of student debt has certainly tested us. Most directly, it has tested Americans working to pay back nearly $1.2 trillion. It has tested our rural areas, many of whom are struggling to attract young, college-educated people to return and reinvest in their communities. It has tested aspiring entrepreneurs, who are looking to create jobs that will help our economy grow, but are often hampered by student debt. It has tested our doctors and health care professionals, many of whom cannot afford to pursue less lucrative jobs and serve the growing population of the elderly. It has tested our realtors and home builders, who are finding that many young Americans can't pursue their dream of buying a home. And of course, it is a test for policymakers on whether or not we will heed the warning signs and avoid the potential negative impacts of growing student loan debt.

In that vein, the Bureau has been continuously collaborating with financial institutions, consumers, investors, and other policymakers to help create a well-functioning market. Together, we can seek to ensure that borrowers can manage their student loan debt and climb the economic ladder.

Understandably, many policymakers across the country are seeking to address some of the underlying drivers of growing student loan debt, including the rising cost of tuition, as well as interest rate structures on Federal student loans. However, it will also be prudent to address the large pool of existing debt owed by millions of Americans.

I hope my testimony can shed additional light on the structure of the student loan market and its similarities to the mortgage market, issues in student loan servicing, potential economic impacts of high levels of student loan debt, past actions by policymakers to assist financial institutions, and opportunities to increase efficiency going forward.

Parallels to the Mortgage Market

Of the approximately $1.2 trillion in outstanding student loan debt, approximately $600 billion was funded using private capital. Nearly three-quarters of the privately funded debt met the criteria for a Government guarantee through the Federal Family Educational Loan Program (FFELP). Financial institutions holding these FFELP loans enjoy a range of subsidies, as well as a guaranteed return in excess of similar duration Treasuries.[2]

While the student loan and mortgage markets may seem completely different, there are some important similarities. In both the mortgage and student loan markets, origination of nontraditional products boomed in the years leading up to the financial crisis. Subprime private label mortgage-backed securities and private student loan asset-backed securities grew rapidly. Investor appetite for these assets led to less stringent underwriting standards, leading many subprime mortgage and private student loan originators to reduce documentation requirements and other checks that ensure high-quality loans. A notable portion of private student loans originated before the crisis did not go through the basic process of verification of

[1] See, for example, the 2012 Annual Report of the Financial Stability Oversight Council, the March minutes of the Federal Reserve Board's Federal Open Market Committee, and the 2012 Annual Report of the Department of the Treasury's Office of Financial Research.

[2] Congress discontinued the Federal Family Educational Loan Program in 2010, though $437 billion in balances remain according to the Department of Education's latest Federal student loan portfolio data. Almost all new Federal student loans are originated by the Department of Education under the Direct Loan program.

a student's enrollment and utilization of other loans. These higher-risk loans also came with higher interest rates.[3]

Many borrowers with subprime mortgages actually qualified for a mortgage with a lower rate. Similarly, more than half of private student loan borrowers did not exhaust their Federal student loan options, which are generally less expensive and have several attractive benefits.[4]

In the mortgage market, many borrowers were unaware of some core features of their mortgage obligation, such as rate resets and other surprises. In a report by the Bureau and the Department of Education to Congress on private student loans, the agencies found that many student loan borrowers were also unaware of what type of loan they had and that their private student loans did not have many options for them in times of distress.[5]

While private student loans are a relatively small share of total outstanding student loan debt, they are disproportionately used by high-debt borrowers. For undergraduate student loan borrowers graduating around the time of the unraveling of the financial crisis with over $40,000 in debt, 81 percent used private student loans.[6]

In the years following the crisis, investors would no longer tolerate the risks associated with many of the practices used to originate subprime mortgages and private student loans. And like the mortgage market, underwriting standards for private student loans have markedly improved, but the existing obligations have not disappeared.

The Quiet Aftershock

The unraveling of the mortgage market and the resulting financial crisis hit our economy like an earthquake. We are all familiar with the trillions of dollars lost in asset values, the millions of Americans who lost their jobs and homes, and the billions of aid deployed to assist financial institutions.

But less discussed is how the crisis has impacted those who were in college. When those students graduated with more debt than they had anticipated, they would also be entering a very difficult job market. In 2007, jobs for college graduates were more plentiful. Unemployment among young Americans with college degrees was 7.7 percent. Less than 2 years later, unemployment for young college graduates had more than doubled, spiking to 15.5 percent.[7] Many continue to be underemployed and are working in job fields that may not require a degree.

A tough job market meant that many Americans needed to find options to honor their mortgage and student loan obligations. But both mortgage and student loan borrowers face two key problems with their servicers.

First, when borrowers do have options, they can still be stymied. In the mortgage market, borrowers whose loans were owned by GSEs had options available to them to modify and refinance their mortgages. Even though some sort of modification may have been in the best interest of the investor and creditor, many mortgage servicers were unable to successfully work with troubled homeowners. A member of the Federal Reserve Board of Governors lamented the "agonizingly slow pace of mortgage modifications and repeated breakdowns in the foreclosure process."[8]

In the student loan market, many borrowers with Government-guaranteed student loans owned and serviced by financial institutions also report difficulty enrolling in Income-Based Repayment and other programs for borrowers facing hardship.

Second, many borrowers have simply run out of options. For homeowners whose mortgages were owned by investors in private-label mortgage-backed securities, they did not always have access to options that would let them find an affordable payment. The same is true with private student loan borrowers who may be facing temporary hardship and looking for an alternative repayment option to get through tough times. Like a business, a consumer's ability to manage cash-flow is absolutely critical to financial health. Private student loan providers generally do not offer this cash-flow management option, which is available to borrowers of Federal student loans.

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[3] Consumer Financial Protection Bureau and Department of Education, Report on Private Student Loans (2012).

[4] Consumer Financial Protection Bureau and Department of Education, Report on Private Student Loans (2012).

[5] Many consumers borrowed both Federal and private student loans from the same financial institution, which also seems to contribute to confusion among some consumers.

[6] National Center for Education Statistics: National Postsecondary Aid Study (2008).

[7] Bureau of Labor Statistics: Recent college graduates in the U.S. labor force: data from the Current Population Survey (2013).

[8] Governor Sarah Bloom Raskin. Speech to the Maryland State Bar Association Advanced Real Property Institute (2011).

For struggling homeowners and student loan borrowers, the consequences of being unable to find an affordable repayment option are severe. The impacts of foreclosures may not just be felt by the former homeowner, but potentially by the entire neighborhood.[9] And for private student loan borrowers who default early in their lives, the negative impact on their credit report can make it more difficult to pass employment verification checks or ever reach their dream of buying a home. As of the end of 2011, more than $8 billion of private student loans were in default, representing 850,000 loans.[10]

Canary in the Coal Mine

The importance of adequate servicing in a functioning mortgage or student loan market cannot be understated. The difficulties faced by mortgage borrowers were investigated by a wide range of Federal and State authorities.[11] Many consumers reported lost paperwork, payment processing errors, and conflicting instructions. A particularly disconcerting occurrence involved the foreclosures faced by active-duty servicemembers, despite prohibitions under the Servicemembers Civil Relief Act (SCRA).

Last October, pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act, we submitted a report on complaints faced by private student loan borrowers.[12] Unfortunately, many of the problems reported by these student loan borrowers bear an uncanny resemblance to those faced by mortgage borrowers. Like in the mortgage market, the treatment of servicemembers by student loan servicers has been quite troubling.[13]

My colleague Holly Petraeus, who leads the Bureau's Office of Servicemember Affairs, and I also published a report describing the obstacles military families face when attempting to use their student loan repayment benefits provided by applicable laws. For example, men and women in uniform are entitled to a 6 percent rate cap on their student loans incurred prior to entering active-duty status, as provided for by the SCRA. Unfortunately, some servicers have placed inappropriate requirements on servicemembers seeking the rate cap.

One servicemember saw his request rejected multiple times because his military orders did not include an end date. This is neither a requirement of the SCRA, nor feasible for many military officers to obtain, as their orders usually do not delineate an end date. Another servicemember with multiple loans sought to reduce the rate on his highest-rate loans, but the servicer proceeded to raise the rate on the loans that were below 6 percent. While many of these problematic practices have subsided since brought to light by this report, we continue to receive these complaints by military families.

In both the mortgage and student loan markets, improper and potentially unlawful servicing errors caused harm to servicemembers. Admittedly, military families are a small segment of the population. But if a servicer is unable to provide adequate service to those who have special protections under the law, it raises questions about whether it is agile enough to deal with the complexities of the larger population of borrowers facing hardship.

I also share the concerns of prospective investors in this sector, whose questions about servicer agility will force them to conduct careful due diligence so that risks are fully understood.[14]

Oversight of Student Loan Servicers

In the Dodd-Frank Wall Street Reform and Consumer Protection Act, the responsibility to supervise insured depository institutions with over $10 billion in assets for compliance with Federal consumer financial laws transferred from prudential regulators to the Bureau. While this includes many servicers owned by large banks with substantial portfolios of Government-guaranteed Federal student loans, as well

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[9] Frame, W. Scott. "Estimating the Effect of Mortgage Foreclosures on Nearby Property Values: A Critical Review of the Literature." Economic Review of the Federal Reserve Bank of Atlanta (2010).

[10] Consumer Financial Protection Bureau and Department of Education: Report on Private Student Loans (2012).

[11] See, for example, *http://portal.hud.gov/hudportal/HUD?src=/mortgageservicingsettlement/investigations.*

[12] Consumer Financial Protection Bureau: Annual Report of the CFPB Student Loan Ombudsman (2012).

[13] Consumer Financial Protection Bureau: The Next Front? Student Loan Servicing and the Cost to Our Men and Women in Uniform (2012).

[14] In theory, investors could rely on the rating agencies, which were compensated to evaluate student loan asset-backed securities, serve to police quality issues, and align incentives of investors, issuers, and servicers. That alignment appears, in retrospect, to have been imprecise for certain ABS issuances prior to the crisis.

as private student loans, most servicing activity takes place within the nonbank sector.[15]

In mortgage servicing, consumers struggled with servicers who were not prepared to handle loss mitigation and loan modification at scale when the financial crisis hit. In contrast, Federal loan guidelines have long offered flexibility to struggling borrowers, so student loan servicers should be able to administer repayment alternatives and other consumer protections efficiently and effectively. Our supervision program will look for that and respond if servicers fall short. Examinations will help determine whether entities have appropriate processes to ensure that borrowers can enroll in modified payment plans available to them, payments are appropriately credited to accounts, and transfers of servicing rights are orderly, among other areas.[16]

While compliance with existing Federal consumer financial laws is critical to protect honest businesses faced by unfair competition from those that cut corners, other structural impediments to repayment of almost $1.2 trillion in existing debt remain for many borrowers.

Student Debt Domino Effect?

While risks in the student loan market do not appear to jeopardize the solvency of the broader financial system, unmanageable student debt may have a broader impact on the economy and society. In February, we asked the public to provide input on potential policy options to tackle the problem of unmanageable student debt. We received more than 28,000 responses from experts and individuals impacted by student debt.[17] Here were some of the potential impacts that participants noted:

Homeownership and household formation: The National Association of Home Builders1A[18] wrote to the Bureau about the relatively low share of first-time homebuyers in the market compared to historical levels and that student debt can "impair the ability of recent college graduates to qualify for a loan." When monthly student loan payments are high relative to income, applicants may be deemed less qualified for a mortgage. The National Association of Realtors[19] wrote in its submission that first-time homebuyers typically rely heavily on savings to fund downpayments. When young workers are putting large portions of their income toward student loan payments, they are less able to stash away extra cash for that first downpayment.

Other submissions cited research that showed that three-quarters of the overall shortfall in household formation can be attributed to reductions among younger adults ages 18 to 34.[20] In 2011, two million more Americans in this age group lived with their parents, compared to 2007.[21]

Entrepreneurship and small business starts: In submissions by coalitions of small business and startups,[22] groups cited a number of factors about the threat of student debt. For many young entrepreneurs, it is critical to invest capital to develop ideas, market products, and create jobs. High student debt burdens require these individuals to take more cash out of their business so they can make monthly student loan payments. Others note that unmanageable student debt limits their ability to access small business credit; some report being denied a small business loan because of their student loans.[23]

Retirement security: In its submission, AARP[24] raised concerns about families headed by an American ages 50 to 64. The association wrote that "increasing debt threatens their ability to save for retirement or accumulate other assets, and may end up requiring them to delay retirement." Student debt can delay participation

[15] In March, the Bureau proposed overseeing larger participants in the nonbank student loan servicing market, to ensure that both banks and nonbanks are on a level playing field. Comments closed on May 28. The Bureau is currently considering the public comments on the proposed rule before reaching any final decisions on the proposed rule.

[16] The Bureau's student lending examination procedures are available to financial institutions and the public. See *http://files.consumerfinance.gov/f/201212_cfpb_educationloanexamprocedures.pdf.*

[17] For the full docket of submissions to this Request for Information, see *http://www.regulations.gov/#!docketDetail;D=CFPB-2013-0004.*

[18] See *http://www.regulations.gov/#!documentDetail;D=CFPB-2013-0004-1042.*

[19] See *http://www.regulations.gov/#!documentDetail;D=CFPB-2013-0004-6822.*

[20] See *http://www.regulations.gov/#!documentDetail;D=CFPB-2013-0004-7202.*

[21] U.S. Census Bureau: Income, Poverty and Health Insurance in the United States, P60—239 (2011).

[22] See, for example, *http://www.regulations.gov/#!documentDetail;D=CFPB-2013-0004-7223.*

[23] See, for example, *http://www.regulations.gov/#!documentDetail;D=CFPB-2013-0004-7223* and *http://www.regulations.gov/#!documentDetail;D=CFPB-2013-0004-7195.*

[24] See *http://www.regulations.gov/#!documentDetail;D=CFPB-2013-0004-6831.*

in employer-sponsored retirement plans, leading to lost growth in the critical early years of a career.

Health care, rural America, and education: The American Medical Association[25] wrote that high debt burdens can impact the career choice of new doctors, leading some to abandon caring for the elderly or children for more lucrative specialties. Aspiring primary care doctors with heavy debt burdens may be unable to secure a mortgage or a loan to start a new practice. This can have a particularly acute impact on rural America, where rental housing is limited and solo practitioners are a key part of the health care system.

Student debt can also impact the availability of other professions critical to the livelihoods of farmers and ranchers in rural communities. According to an annual survey conducted by the American Veterinary Medical Association, 89 percent of veterinary students are graduating with debt, averaging $151,672 per borrower.[26] Veterinarians encumbered with high debt burdens may be unable to make ends meet in a dairy medicine or livestock management practice in remote areas.

Classroom teachers submitted letters detailing the impact of private student loan debt, which usually don't offer forgiveness programs and income-based repayment options. One school district official wrote to the Bureau noting that programs to make student debt more manageable could lead to higher retention of quality teachers.[27]

Competitive Market?

The student loan market has generally not exhibited signs of robust competition—even when private market participants dominated. In the Federal Family Educational Loan Program, financial institutions could receive subsidies and guarantees if loans met certain criteria. Congress set statutory interest rate caps; in theory, the most efficient private actors would attract customers by providing the lowest possible price on a commodity product.

Unfortunately, this was generally not the case. While lenders made limited use of incentives, such as waivers of some origination fees, those who charged the statutory maximum were not competed out of the market. Even when borrowers were offered various advertised incentives, most borrowers would never benefit from those incentives.[28] Instead of offering competitive prices to student loan borrowers, many financial institutions drew scrutiny for business models that provided benefits to schools and financial aid officials, who are able to strongly influence student loan choices by students and families.[29]

Servicing of student loans and origination of private student loans remains fairly concentrated within a relatively limited number of players. Refinancing activity has been low, potentially due to this lack of robust competition. In addition, even when both the borrower and creditor may be better off with some sort of alternative repayment plan when a borrower is in distress, restructuring activity in the market is troublingly low.

Like mortgage borrowers, many private student loan borrowers want to repay their obligations, but simply need an alternative payment plan to weather tough times in the labor market. In addition, borrowers with both Federal and private student loans have been frustrated with the inability to refinance fixed-rate loans to take advantage of today's historically low interest rates and their improved credit profile.[30] If these issues are not addressed, there may be a negative impact not just on consumers, but also on the broader economy.

Assisting Financial Institutions in the Crisis

In 2008, distress in the credit markets led the Federal Government to enact policies to assist financial institutions to raise capital for student loan issuance. While

[25] See *http://www.regulations.gov/#!documentDetail;D=CFPB-2013-0004-0878.*

[26] See *https://www.avma.org/news/journals/collections/pages/avma-collections-senior-surveys.aspx.*

[27] See *http://www.regulations.gov/#!documentDetail;D=CFPB-2013-0004-0038.*

[28] For example, in a 2007 letter, Sallie Mae CEO Tim Fitzpatrick discussed how just 10 percent of borrowers end up benefiting from advertised incentives.

[29] The Attorney General of New York entered settlements and code of conduct agreements to address this problem in 2007 with many schools and lenders, including the two largest lenders at the time: Sallie Mae and Citigroup.

[30] It is worth noting that the absence of a developed student loan refinance market may be an impediment to monetary policy transmission. Savings from low borrowing costs for financial institutions are not necessarily being passed on to student loan borrowers with fixed-rate obligations. Given that student loan debt is the largest form of debt for a large portion of younger households, a robust student loan refinance market may be a prerequisite for monetary policymakers to ensure that younger households can accrue benefits from the low interest rate environment.

these programs were primarily designed to help financial institutions originate more loans, understanding them might also be useful for policymakers seeking to find ways to increase efficiency and competition in the market for the benefit of borrowers.

The ECASLA Authority

In 2008, the Ensuring Continued Access to Student Loans Act (ECASLA) was enacted, providing the Secretary of Education the authority, with the consent of the Secretary of the Treasury and the Director of the Office of Management and Budget, to establish mechanisms to ensure that students and families had continued access to Federal student loans regardless of conditions in the credit markets. All programs administered under this authority were required to have no net cost to taxpayers.

The Secretary of Education exercised this authority to intervene in the credit markets by creating a number of loan purchase programs, as well as a complex asset-backed commercial paper conduit that would pledge Federal support for financial institutions and other lenders seeking to access funding to finance Federal student loans. ECASLA permitted the Secretary of Education to purchase certain Federal student loans, provided that the owners of these Government-guaranteed loans use the proceeds to originate new Federal student loans for borrowers.

Another program established by the Secretary (designed by Citigroup, Morgan Stanley, and a committee of lenders) provided financing to lenders through issuance of commercial paper. Under this program, the Government was obligated to buy this commercial paper if investors do not.[31]

Lenders were able to transfer Government-guaranteed existing loans into a special purpose vehicle, Straight-A Funding, LLC, which in turn would facilitate the issuance of commercial paper issued to investors. The Secretary of Education would purchase any commercial paper not sold to investors, while the Secretary of the Treasury (through the Federal Financing Bank) provided temporary financing. In total, the conduit advanced $41.5 billion in commercial paper to assist about two dozen lenders, who benefit from the Government's lower cost of capital.[32]

The Secretary of Education's actions under the ECASLA authority injected significant liquidity into the market. Financial institutions originated tens of billions of dollars in new loans in the subsequent academic year, potentially due to the favorable cost of capital as a result of Federal intervention. At the end of 2010, the Secretary of Education had purchased a total of $110 billion in Federal student loans from private sector lenders. While there was no budgetary cost to taxpayers, the asset purchase programs did lead to some cases of extraordinary gains when holders of Government-guaranteed student loans sold those loans to the Secretary of Education.[33]

The TALF Program

In early 2008, the asset-backed securities (ABS) market came under intense strain, and by October 2008, the market was nearly frozen. Because ABS had historically funded consumer and small business credit, a complete halt in the ABS trading markets would have undoubtedly limited credit availability to households and small businesses. Citing "unusual and exigent circumstances", the Federal Reserve Board authorized the Term Asset-Backed Securities Loan Facility (TALF), under section 13(3) of the Federal Reserve Act.[34]

TALF did not provide loans directly to consumers. The program provided non-recourse loans to purchasers of TALF-supported ABS, where the ABS was held as collateral. In other words, entities could borrow at attractive rates from the program to purchase qualifying ABS. Securities backed by Federal student loans and private student loans were eligible for TALF support. Two student lenders offered approximately $9 billion in TALF-supported ABS issuances in 2009 and 2010: Sallie Mae and Student Loan Corp (then a unit of Citigroup).[35]

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[31] For further information on the asset-backed commercial paper conduit facility established under the ECASLA authority, see *http://ifap.ed.gov/ECASLA/ABCP.html.*

[32] While financial institutions no longer originate Federal student loans, many lenders still have obligations through the Straight-A Funding, LLC, asset-backed commercial paper conduit facility. For example, one of the largest participants, Sallie Mae, had outstanding borrowings of over $16 billion at an average interest rate of 0.82 percent, as of the end of 2012.

[33] See, for example, SLM Corp., 10–K Annual Report for Fiscal Year 2009 (2010) and SLM Corp., 10–K Annual Report for Fiscal Year 2010 (2011).

[34] It is worth noting that this authority was subsequently amended by Section 1101 of the Dodd-Frank Wall Street Reform and Consumer Protection Act.

[35] For further information and data on TALF loans and issuances, visit *http://www.federalreserve.gov/newsevents/reform_talf.htm.*

TALF was successful in jumpstarting ABS issuance of private student loans. In 2009, the majority of student loan ABS issuances were TALF-supported, totaling approximately $10 billion. No losses have been experienced by TALF thus far. All student loan ABS issued under TALF provided funding for private student loans. While Federal student loans were eligible, there were no Federal student loan ABS issuances under TALF.

Path Forward

Last month, the Bureau published a report on student loan affordability that discusses what we learned from the public about potential solutions for the market.[36] During the crisis, policymakers employed a number of creative tools to revive the student lending market, as discussed above. Policymakers might now focus on the following objectives to increase private capital participation and market efficiency:

Spurring loan restructuring opportunities: Some of those who submitted comments suggested options to help borrowers in distress, including those who have fallen behind on private loans.

Most private student loans have few options available for alternative payment plans. Many of those who submitted to the Bureau's request for information noted that if lenders had more incentive to work with borrowers trapped in debt, both could benefit. Policymakers might look to provide a path forward for those borrowers, creating a transparent step-by-step process that leads to affordable payment terms where monthly payments can match a reasonable debt-to-income ratio and repayment of the loans can be more affordable.

Even if such a program required public funds, or a sharing of the cost between the public sector and the owners of the loans, the economic benefits of facilitating restructuring activity at scale might outweigh program costs.

Jumpstarting a student loan refinance market: For borrowers who have dutifully managed their monthly payments on high-interest private student loans, many raised the need for a way to refinance. This approach could give responsible borrowers the opportunity to swap their existing loan for a new loan at market interest rates that reflect their current credit profile.[37]

Students generally apply for private student loans when they are young, have little to no credit history, and are not yet employed. Lenders have to consider the possibility that borrowers won't graduate or find a job with a salary that allows them to meet their monthly payment. These risks are priced into new private student loans.

Most borrowers do attain employment though, and have been honoring their promises to pay, but they simply can't find a refinance option. When mortgage borrowers see rates plummet and see their incomes rise, they try to refinance. Responsible student loan borrowers should have this option, too.

Conclusion

Thank you for the opportunity to share insight on the state of the student loan market. We look forward to continued dialogue with industry, consumers, institutions of higher education, and policymakers to ensure that we confront the significant challenges faced by student loan borrowers. While there has recently been considerable discussion about interest rates on Federal student loans for borrowers next year, it will be important to address the potential impacts of the heavy burdens for the millions of Americans already in debt.

If we are collectively successful, we can help a generation of new graduates serve as an economic engine—bettering themselves, the financial institutions that serve them, and the rest of society.

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[36] Consumer Financial Protection Bureau: Student Loan Affordability (2013). This report specifically addresses issues policy options for borrowers in repayment. Pursuant to the Section 1077 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, the Bureau and the Department of Education also put forth recommendations to Congress in July 2012 addressing other aspects of the private student loan market.

[37] One unusual market trend is noteworthy here. Some private student lenders are enjoying increasing net interest margins, which is unlike the experience of lenders of other consumer financial products in today's interest rate environment. This may demonstrate a lack of competition, as well an opportunity for more efficient private capital participation.

PREPARED STATEMENT OF JOHN C. LYONS

SENIOR DEPUTY COMPTROLLER
BANK SUPERVISION POLICY AND CHIEF NATIONAL BANK EXAMINER
OFFICE OF THE COMPTROLLER OF THE CURRENCY *

JUNE 25, 2013

Introduction

Chairman Johnson, Ranking Member Crapo, and Members of the Committee, I appreciate this opportunity to discuss private student lending, and the OCC's supervisory approach for national banks and Federal savings associations (hereafter, national banks and thrifts) engaged in this business. Promoting fair and equitable access to credit, including education financing, is a core OCC mission and one of our most important priorities. We work hard to ensure that national banks and thrifts offer and manage consumer credit portfolios in a safe and sound manner that promotes long-term access to credit across a spectrum of consumer products. National banks and thrifts have a long history of participation as lenders and servicers of Federal and private student lending programs; however, they are not dominant players in this market, and their current portfolio holdings of private student loans represent just 3 percent of the total $966 billion in student loans outstanding.

We also have a longstanding policy of encouraging national banks and thrifts to work constructively with borrowers who may be facing hardship. As my testimony will describe, with respect to private student loans, we allow national banks and thrifts to offer additional flexibility when working with student borrowers in recognition of the unique challenges these borrowers face. This flexibility includes extended grace periods for loan repayments that go beyond what is permitted for other types of consumer credit. For long-term hardship cases, national banks and thrifts may also permanently reduce the interest rate or otherwise modify payments to assist the borrower.

As requested by the Committee's letter of invitation, my testimony provides an overview of trends in student lending and national bank and thrift participation in the private student loan market. I will describe applicable regulatory guidance as well as the OCC's supervisory approach to private student loans. I will also address programs that national banks and thrifts may offer to assist borrowers who may be facing temporary hardship due to the current job market. My testimony concludes with a discussion of various recommendations that have been made to enhance the private student loan market and to help mitigate loan defaults, including a discussion of common workout programs for Federal student loans and their applicability to private student loans.

Background

I want to begin by describing some of the unique challenges student loans can pose for lenders and borrowers and how the OCC has responded to those challenges. For most consumer loans, such as automobile loans, the underwriting, loan structure, and account management are straightforward. The use of funds is for a specific purpose, and the source of repayment is well defined, structured, and can be readily assessed at origination. In contrast, private student loans are unique for three main reasons: first, funding a post-secondary education often requires a substantial, multi-year-term commitment that extends from the time the student starts school until repayment begins once he or she has finished his or her education; second, advances made under private student loans are usually uncollateralized; and third, a substantial time period exists between the date when the lender advances funds and when that student reaches his or her anticipated earnings potential. Private student loans also differ from Federal student loans in that the Government does not guarantee repayment. For this reason, many lenders require that private student loans have cosigners.

Private student loans provide flexibility for deferment while borrowers are in school, and post-school grace periods to help borrowers transition from school to employment. Student loans are the only consumer product with such a transition period. This flexibility reflects both the unique circumstances of the student borrower and that these loans truly are an investment in the borrower's future. As my testimony will describe, the OCC believes this flexibility, if properly applied, supports

* Statement Required by 12 U.S.C. § 250:

The views expressed herein are those of the Office of the Comptroller of the Currency and do not necessarily represent the views of the President.

student borrowers, and allows lenders to make private student loans and manage the resulting credit exposures in a safe and sound manner.

When borrowers experience financial difficulties, the OCC encourages national banks and thrifts to work with the borrower by offering prudent forbearance and modification programs. We recognize that well-designed and consistently applied workout programs can help borrowers resume structured, orderly repayment and minimize losses. Such work out programs are fundamental to effective lending, and ultimately, benefit both the borrower and the financial institution.

The interagency Uniform Retail Classification and Account Management Policy (Uniform Classification Policy) contains general guidance for consumer credit forbearance and modification programs.[1] This policy acknowledges that extensions, deferrals, renewals, and rewrites of consumer loans can help borrowers overcome temporary financial difficulties such as unemployment, medical emergency, or other life events. It further notes that prudent use of these loan modification measures is acceptable when based on the borrower's willingness and ability to repay the loan, and when the modification is structured in accordance with sound internal policies.

While the Uniform Classification Policy provides general guidance regarding extensions, deferrals, renewals, and rewrites, it does not specifically address private student loan workout and forbearance practices, nor does it directly address the unique challenges that student lenders and borrowers may face. To address these issues, the OCC issued supplemental guidance to our examiners in 2010 that interprets the Uniform Classification Policy in the context of private student lending, and describes the OCC's minimum expectations for managing forbearance, workout, and modification programs (The Student Lending Guidance or Guidance).[2] The Student Lending Guidance explicitly permits national banks and thrifts to engage in the following actions to assist borrowers:

- *In-school deferments*—allows a lender to postpone a borrower's principal and interest payments as long as the borrower is enrolled in school at least as a half-time student.
- *Grace periods*—allows lenders to defer a borrower's payments for 6 months immediately following the borrower's departure from school, without conditions or hardship documentation.
- *Extended Grace periods*—allows lenders to defer a borrower's payments for an additional 6 months immediately following the initial grace period. This option is for those borrowers who are experiencing a financial hardship and is available to student loan borrowers who are unemployed or under-employed.
- *Short-term forbearance*—allows lenders to offer two-to-three month loan extensions to a borrower to address short-term hardships.
- *Loan Modifications*—allows lenders to provide interest rate and payment reductions to borrowers who are experiencing long-term hardships.

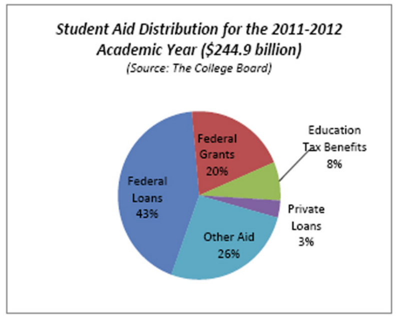
The first three actions primarily help borrowers while they are in school and as they transition to full-time employment, and are unique to student loans. The extended grace period in particular is a direct response to the difficult employment conditions that many students are experiencing. Under our guidance, a national bank or thrift may allow a borrower facing difficulty in finding a job to not make any payment for up to 12 months after he or she leaves school. Upon completion of the extended grace period, the borrower is considered current and will remain in that status as long as scheduled payments are met. If the borrower is still experiencing hardship at the end of this extended grace period, we would expect the bank to work with the borrower and determine whether additional actions are warranted. Such actions may include the forbearance, workout, and modification programs allowed under the interagency Uniform Classification Policy. We also require banks to maintain appropriate loan loss allowances and regulatory capital levels, consistent with applicable accounting and regulatory requirements. Working constructively with troubled student borrowers, while adhering to prudent accounting principles, provides appropriate flexibility for both assisting troubled student borrowers and protecting the safety and soundness of the institution.

[1] Uniform Retail Classification and Account Management Policy, 65 Fed. Reg. 113 (June 12, 2000).

[2] CNBE Policy Guidance 2010–02, "Policy Interpretation: OCC Bulletin 2000–20—Application to Private Student Lending."

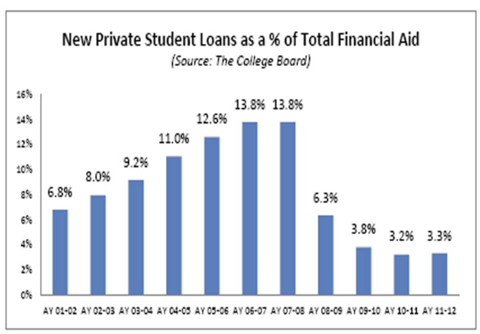
Trends in Private Student Lending

In 2012, The College Board released its most recent "Trends in Student Aid Report"[3] that included preliminary data for the academic year 2011–2012. Student aid includes loans (Federal and private), grants, work-study, and education tax benefits.



According to The College Board, total financial aid for academic year (AY) 2011–2012 was approximately $245 billion. Federal loans represented $105.3 billion for AY 2011–2012, or 43 percent of total aid. By comparison, private student loans for AY 2011–2012 were $8.1 billion, or 3 percent of total aid. This was similar to AY 2010–2011 and down substantially from the $25.6 billion in private student loans originated during the peak AY of 2007–2008.

The student aid distribution in AY 2011–2012 continued recent trends, where Federal aid (loans and grants) are the principal source of student aid, while private student lending provides a supplement to help with shortfalls. Private student loan share peaked in AY 2007–2008 at just below 14 percent ($25.6 billion), but has been a much smaller share since then. After 2008, the financial crisis, high unemployment, weaker loan performance, and reduced securitization funding all contributed to lower market share in absolute and relative terms. We see little indication that private student lending volumes will increase or return to mid-2000 levels in the near term.



National Bank and Thrift Participation in the Private Student Loan Market

Total outstanding private student loans are difficult to estimate since volumes are not collected as part of call report or public financial statement reporting. Industry estimates place year-end 2012 totals somewhere between $126 and $150 billion. For this discussion, we use the Federal Reserve Bank of New York's estimates of $126 billion for private student loans and $996 billion for total student loans, both as of December 2012.[4]

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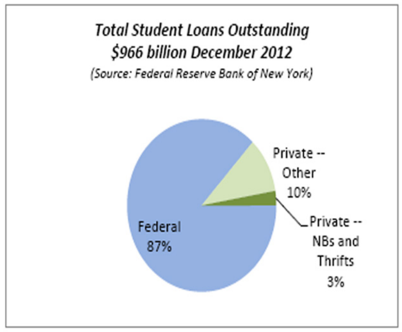
[3] Trends in Student Aid 2012, The College Board, *www.collegeboard.org.*

[4] Quarterly Presentation on Household Debt and Credit, May 2013, Federal Reserve Bank of New York.



As the chart above shows, Federal loans dominate the student loan market, with 87 percent, or approximately $849 billion of the total $966 billion that was outstanding at the end of 2012. Within the private segment of the student loan market, national banks and thrifts hold approximately $27 billion of the remaining $126 billion in student loans, or roughly 21 percent of the private market and 3 percent of the total $966 billion outstanding. The "Private—Other" segment in this chart includes other non-OCC supervised financial institutions.

National bank and thrift participation in the private student lending market is highly concentrated, with only eight lenders holding portfolios of $500 million or more. Wells Fargo, JPMorgan Chase, Citibank, KeyBank, PNC, RBS Citizens, Bank of America, and U.S. Bank combined hold approximately $25.8 billion in private student loans, with Wells Fargo accounting for slightly more than 40 percent of the total. Of the eight banks, four have ceased making new private student loans since 2008 due primarily to concerns about portfolio performance and liquidity. The second largest, JPMorgan Chase, only offers new private student loans to existing bank customers.

Within these portfolios, a greater number of borrowers have concluded the in-school deferment phase, and have started repayment. For the eight largest banks, more than 70 percent of the outstanding loans are in repayment, and overall delinquencies are relatively low, generally between three to 4 percent; only one of the eight largest lenders has a delinquency level in excess of 4 percent. In addition, all eight of these banks offer forbearance and extended grace programs. At the end of 2012, these banks had almost $750 million combined in active post-school deferment. Loss rates for loans in repayment are also relatively low, with the average for the eight largest private student lenders at 4.6 percent. These delinquency levels are manageable, and compare favorably to the overall student loan market and are considerably lower than the current delinquency rates for residential mortgages. The low levels associated with these private student loans reflect the quality of underwriting, including a greater prevalence of cosigners, and better risk selection than were evident after 2008.

How the OCC Supervises Consumer Credit Portfolios

Most lenders' consumer credit portfolios, including student loan portfolios, consist of a significant number of loans, with standardized underwriting, loan structures, and repayment terms. Because of the volumes involved, such standardized process-related decisions (credit score floors, credit line assignment, documentation of income, *etc.*) are critically important for consistent and timely credit decisions. Supervisory oversight generally focuses on the quality of the bank's or thrift's decision-making processes and on internal controls and audit. For safety and soundness purposes, the OCC focuses on whether management has established prudent risk tolerances, developed effective account management practices, and has a fundamental, disciplined understanding of portfolio quality.

Prudent risk tolerances generally involve establishing well-defined underwriting and repayment structures. The OCC expects national banks and thrifts to employ underwriting standards that consider both a borrower's willingness and capacity to repay any credit extended, based on reliable information prior to making the loan.

Effective account management and collection practices include active monitoring of loan performance and timely actions when issues arise. This includes the use of forbearance and modification programs that are designed to benefit both the borrower and the bank by improving the likelihood of repayment. As with risk tolerances, we expect lenders to consider and articulate accepted and prudent use of modification programs in advance, and then manage these activities within defined parameters.

Understanding portfolio quality generally involves robust, timely reporting that identifies loans or portfolio segments that are not performing as expected. A bank's portfolio monitoring should include new and existing loans, as well as the range of loss mitigation and collection activities that it uses. A comprehensive and accurate view of a loan portfolio's risk is critical for effective forbearance, workout, and modification programs.

The interagency Uniform Classification Policy establishes standard guidelines for loan classification and charge-off. Under that policy, consumer loans 90 days past due are classified "substandard,"[5] and amortizing loans that become 120 days past due are classified "loss,"[6] and charged-off. This is one aspect where the regulatory treatment for Federal student loans and private student loans differs. While both types of loans are uncollateralized, generally banks are not required to charge-off loans that are federally guaranteed.[7]

Designating a loan as "loss" does not mean that a lender should stop the use of workout or modification programs, or that loss mitigation or collection efforts should cease. It simply means that for safety and soundness reasons and financial and investor transparency, the bank should follow appropriate accounting practices and reflect the increased credit risk in its financial statements.

The Uniform Classification Policy does not prohibit or discourage a bank from working with troubled borrowers nor does it dictate when a bank can begin to work with a borrower who may be facing hardship. We believe that full, objective analysis and timely identification of problem loans encourage lenders to work with troubled borrowers at an early stage when programs generally have a higher probability of improving repayment and reducing losses. To be effective, however, forbearance and modification programs need to be based on accurate assessments of risk and reliable information.

As previously noted, private student loans raise unique issues that are not explicitly addressed by the Uniform Classification Policy. In early 2010, OCC examiners noticed inconsistent practices regarding the use of grace and forbearance periods for borrowers who were transitioning from school to full-time employment. In response, the OCC issued the Student Lending Guidance to address the unique challenges associated with private student loan programs. As mentioned previously, that Guidance acknowledges the challenges that borrowers face shifting from school into the workforce, and recognizes the need to facilitate orderly transitions. To facilitate that transition, the Guidance allows a bank to defer a borrower's payments for up to a year.

The Guidance also specifically allows national banks and thrifts to offer loan modifications, but we expect such modifications will reflect three key concepts: i) eligibility and payment terms that are based on a credible analysis of the borrower's hardship and reasonable ability to repay; ii) sustainable payment schedules that avoid unnecessary payment shock; and iii) revised loan structures that promote orderly repayment and do not include elements such as interest-only payments, balloon payments, and negative amortization.

A credible analysis of the borrower's difficulties and the use of payment terms that are sustainable ensure that a modified student loan is likely to be successful over the long term. Moreover, modification programs should address hardship and payment issues directly, with the objective of improving the borrower's ability to repay. The Guidance discourages the use of payment terms such as interest-only and negative-amortization. Such payment structures delay problem recognition in the hope economic or other market conditions might quickly improve and resolve the issue, but often will leave the borrower exposed to uncertain market conditions, and ultimately, higher costs as a result of the payment deferrals or increases in principal balance.

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[5] Under the agencies' regulatory classification guidelines, "substandard" assets are defined as assets that are inadequately protected by the current sound worth and paying capacity of the obligor or collateral pledged, if any. Assets so classified must have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the institution will sustain some loss if the deficiencies are not corrected.

[6] An asset classified "loss" is considered uncollectible, and of such little value that its continuance on the books is not warranted. This classification does not mean that the asset has absolutely no recovery or salvage value; rather it is not practical or desirable to defer writing off an essentially worthless asset (or portion thereof), even though partial recovery may occur in the future.

[7] Under Federal student loan program guidelines, Federal student loans that are 270 days past due are considered to be in default.

Finally, while the OCC encourages national banks and thrifts to work with troubled borrowers, offering prudent forbearance, workout, and modification programs does not relieve these institutions of their fiduciary responsibility to ensure that regulatory reports and financial statements are accurate and fairly represent the financial condition of the institution. This tends to be a point of confusion, as some mistake the expectation of full and accurate reporting as limiting available forbearance, workout, and modification programs. To be clear, the Student Lending Guidance allows options and flexibility to lenders in offering forbearance and modification programs to private student loan borrowers, but requires banks to ensure the integrity of their books and records by reporting the volume and nature of transactions accurately. These options and responsibilities are not mutually exclusive, and together promote a safe and sound banking system.

Consistent with Section 121 of the FDIC Improvement Act of 1991, national banks and thrifts offering workout and modification programs are expected to follow generally accepted accounting principles (GAAP) to ensure transactions are accurately reflected in the institution's regulatory reports and financial statements.[8] In general, under GAAP a bank must recognize a loan modification for a financially troubled borrower that includes concessions as a troubled debt restructuring (TDR), with appropriate loan loss provisions if impairment exists.[9] The designation of a loan as TDR does not prohibit or impede a bank's ability to continue to work with the borrower.

Potential Enhancements to the Private Student Loan Market and Mitigation Efforts

A number of thoughtful studies have highlighted policy recommendations to strengthen student lending programs, including the Consumer Financial Protection Bureau's July 2012 and March 2013 reports. Some of these recommendations are aimed at improving the transparency and clarity of student loan programs and loan terms to help ensure that students and their families can make informed decisions. The OCC supports proposals that would enhance borrowers' ability to understand and compare various financial products and options that may be available. Likewise, we support loan documents and billing statements that allow a borrower to fully and readily comprehend his or her financial obligation.

Other recommendations have focused on exploring permissible mitigation efforts for student borrowers who are facing difficulties and whether plans permitted under current Federal loan repayment programs can be used for private student loans. As previously discussed, the OCC believes its guidance provides national banks and thrifts with appropriate flexibility in providing loan modifications to troubled borrowers. This flexibility includes the ability to adapt features of repayment programs used for federally guaranteed student loans to private student loans, as described below.

Graduated Repayment Plans—Most Federal student loans allow a lender to establish a payment schedule where the borrower's payment obligation starts low and then increases over time. Initially, payments can be interest only, and no required payment plan can be more than three times any other payment. Loan terms are generally 10 years (excluding in-school, grace, deferment, or forbearance periods) or 25 years for borrowers with an extended repayment term.

Graduated payment terms that are part of the payment structure at origination are permissible and consistent with existing regulatory guidance. In the case of student loans, programs that include such payment terms recognize that borrowers are likely to have significantly lower income with entry-level jobs at the beginning of the payment period, and that their income may increase significantly over the next few years. Under GAAP and regulatory reporting guidelines, a bank offering a graduated payment plan as a workout concession to a financially distressed borrower generally would have to report the loan as a TDR and take an appropriate impairment charge to earnings.

Income-Based Repayment Plans—These are payment plans for Federal student loans where monthly payments are based on a borrower's expected total monthly gross income and family size. Such plans require the borrower to show a hardship, and payments are generally limited to 15 percent of eligible income. Any remaining loan balance is forgiven after 25 years.

For private student loans, income-based loan modifications are consistent with regulatory expectations and typically form the basis for prudent modification pro-

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[8] See 12 U.S.C. 1831n.

[9] The Glossary section of the Call Report Instructions provides regulatory guidance for the identification of TDRs and associated allowance methodologies under the topics Troubled Debt Restructures and Loan Impairment.

grams. Given that payment and principal concessions are due to the borrower's financial hardship, these modified loans likely would require TDR designation under GAAP, and would require appropriate recognition, carrying values, and impairment allowances. As a modification, we would expect that approved payment terms would not reflect interest-only or negative amortization provisions. In addition, any balances forgiven would likely require full loan loss allowance coverage, or be charged-off.

Consolidation Loans—Federal programs allow borrowers to combine multiple student loans into one consolidated loan, simplifying the repayment obligation. The consolidated loan's repayment term is determined by the total loan balance, and can extend from 10 years to 30 years. Borrowers pay a fixed interest rate equal to the weighted average interest rate of the underlying loans.

Consolidating loan balances is also permitted under existing regulatory policies. Since consolidated loans generally do not include concessions to troubled borrowers, extending their use to private student loans likely would not require TDR designation. As with any consumer loan, a lender should have reasonable underwriting criteria that considered a borrower's reasonable willingness and ability to repay the full amount of the consolidated loan.

Loan Rehabilitation Programs—A Federal student loan that has defaulted (*i.e.,* more than 270 days delinquent) can be returned to performing status if the borrower makes at least nine on-time payments in a 10-month period. This rehabilitated loan must retain the same interest rate, repayment terms, and other benefits that were applicable when the loan was first disbursed, and collection costs and accrued interest are capitalized and built into the principal balance of the loan. After a Federal student loan has been rehabilitated, the loan's default status is deleted from the borrower's national credit bureau reports, and, pursuant to the loan's original terms, any benefits that were available before the borrower defaulted (such as deferment, forbearance, or consolidation) are reinstated.

Rehabilitation programs for Federal student loans are late-stage actions that occur well after normal collection activities for private student loans are exhausted. As previously noted, once a private student loan becomes 120 days past due, the Uniform Classification Policy indicates that the institution is expected to record the exposure as a loan loss and charge-off any remaining loan balance. Work out activities may continue post-charge-off, including payment plans for financially troubled borrowers, but any amounts received from the borrower are treated as recoveries. Charged-off loans are rarely re-booked as performing assets. This discipline is an important part of financial statement transparency, and ensures that lenders accurately report their balance sheets and capital.

The OCC believes that full and accurate reporting to credit bureaus that includes updated default status for loans that subsequently perform as well as their prior history, is important for both lenders and borrowers. Much of the depth and breadth of the $11 trillion consumer credit market is tied directly to objective and accurate bureau transaction data that supports credit decisions and other account management practices.

Conclusion

We recognize that access to higher education remains an important public policy objective, and that cost-effective funding for an education can be a challenge for students and their families. Private student lending is a relatively small but important part of the student aid package, but still can contribute to the substantial debt burden that some students have once they leave school.

The OCC encourages national banks and thrifts to work constructively with troubled borrowers, and expects banks and thrifts to make informed, objective decisions in workout situations. For troubled loans, most often this means active loss mitigation practices that include forbearance, workout, and loan modification programs. We believe that our guidelines provide lenders with the flexibility necessary to work with troubled private student loan borrowers, including permitting the lenders to take advantage of a number of the options currently used in connection with Federal student loans. In particular, we recognize the challenges that student borrowers can have finding employment during difficult economic conditions, and in response, we have allowed grace periods to extend up to a full year to help these borrowers as they transition into the work force.

These and other forbearance and modification programs are consistent with safety and soundness principles and complement prudent underwriting practices. Both help borrowers handle debt responsibly, and avoid default during periods of hardship, and both are important for vibrant and sustainable loan markets.

PREPARED STATEMENT OF TODD VERMILYEA

SENIOR ASSOCIATE DIRECTOR, DIVISION OF BANKING SUPERVISION AND REGULATION
BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

JUNE 25, 2013

Chairman Johnson, Ranking Member Crapo, and other Members of the Committee, thank you for the opportunity to testify at today's hearing. First, I will discuss recent student loan market trends and the portfolio performance of both Government-guaranteed and private student loans. I will then address the Federal Reserve's approach to supervising financial institutions engaged in student lending and close by briefly discussing the implications of rising student debt levels and default rates on other forms of lending.

Background

The Federal Reserve has supervisory and regulatory authority for bank holding companies, State-chartered banks that are members of the Federal Reserve System (State member banks), savings and loan holding companies, and certain other financial institutions and activities. We work with other Federal and State supervisory authorities to ensure the safety and soundness of the banking industry and foster the stability of the financial system.

Student Loan Market

The student loan market has increased significantly over the past several years, with outstanding student loan debt almost doubling since 2007, from about $550 billion to over $1 trillion today. Balances of student loan debt are now greater than any other consumer loan product with the exception of residential mortgages, and it is the only form of household debt that continued to rise during the financial crisis. Outstanding education loan debt is now greater than credit card debt, home equity lines of credit, or auto debt on consumers' balance sheets.

Since 2004, both the number of student loan borrowers, and the average balance per borrower, has steadily increased, according to data compiled by the Federal Reserve Bank of New York. In 2004, the share of 25-year-olds with student debt was just over 25 percent; today, that share has grown to more than 40 percent. At the end of 2012, the number of student loan borrowers totaled almost 40 million and the average balance per borrower was slightly less than $25,000. In 2004, the average balance was just over $15,000. In 2012, roughly 40 percent of all borrower had balances of less than $10,000; almost 30 percent had balances between $10,000 and $25,000; and fewer than 4 percent had balances greater than $100,000.

This sharp increase in student loan borrowing likely reflects a number of factors. Demand for student loans has risen in line with the increasing cost of higher education; increasing enrollment in post-secondary education; a relative decline in household wealth brought about by the financial crisis and the ensuing recession; and more favorable terms on Government-guaranteed loans.

The rising cost of higher education and the decline in wealth coincided with a difficult job market, which may have encouraged more people to enroll in higher education, or stay in school to pursue advanced degrees immediately after graduation. Notably, enrollment in degree-granting institutions increased at an annual rate of about 5 percent between 2007 and 2010, compared with a historical increase of 3 percent since 1970. It is also important to note that underwriting standards and terms of Federal student loans have been favorable relative to other borrowing alternatives over the past few years. As a result, households likely substituted student loans for other sources of education financing, such as home equity loans, credit card debt, or savings. All of these factors have contributed to the rapid rise in student loan debt levels and seem likely to have been influenced by the financial crisis.

The student loan market is bifurcated into Government-guaranteed loans and private student loans that are not guaranteed.[1] Government-guaranteed loans represent approximately 85 percent of total student debt outstanding, and private loans represent just 15 percent. While Federal student loan originations have continued to increase each year, private loan originations peaked in 2008 at roughly $25 billion and have since dropped sharply to just over $8 billion. New Government-guaranteed student loan originations topped $105 billion in 2012, comprising 93 percent of all new loans.

[1] In July 2010, the Federal Government stopped guaranteeing student loans made through private lenders.

Terms and conditions of Government-guaranteed loans are generally set by a Federal formula established by the Congress. Although a credit check is not required for most types of Government-guaranteed loans, borrowers may be turned down if they are delinquent on an existing student loan. Private loan standards are set by the lending institutions and generally require full underwriting, including a credit check. Private loans also increasingly require a guarantor. Most Government-guaranteed and private student loans provide the borrower with a 6-month grace period after leaving school before payments begin.

Performance of Student Loan Portfolios

In line with the rapid growth in student loans outstanding, the number of student loans—private and guaranteed—that are currently delinquent has risen sharply as well, standing at 11.7 percent of all outstanding student loans in 2012.[2] However, some 44 percent of student loan balances are not yet in their repayment periods, and if these loans are excluded from the data pool, the effective delinquency rate of loans in repayment roughly doubles to 21 percent. By comparison, in 2004, only 6.3 percent of student loans were in delinquency.

According to the Consumer Financial Protection Bureau (CFPB), of the $1 trillion in total outstanding student loan debt, $150 billion consists of private student loans. It is important to note that the private student loan market includes loans made not only by banks, but also loans made by credit unions, State agencies, and schools themselves. The rate of delinquency among these loans is roughly 5 percent, according to the CFPB, less than half of the delinquency rate for all outstanding loans.

There are likely a number of factors underlying the difference between the performance of the Government-guaranteed and private student loan portfolios. For instance, underwriting standards in the private student loan market have tightened considerably since the financial crisis. Almost 90 percent of these loans now require a guarantor or cosigner, usually a parent or legal guardian.

Federal Reserve Supervision of Student Loan Market

The Federal Reserve has no direct role in setting the terms of, or supervising, the student loan programs. The Department of Education is responsible for administering the various Federal student loan programs, which, as noted earlier, comprise about 85 percent of the student loan market. The Federal Reserve does, however, have a window into the student loan market through our supervisory role over some of the banking organizations that participate in the market. We share this role with the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, and the National Credit Union Administration.

Federal Reserve supervision of participants in the student loan market is similar to our supervision of other retail credit markets and products. Institutions subject to Federal Reserve supervision—including those with significant student loan portfolios—are subject to onsite examinations that evaluate the institution's risk-management practices, including the institution's adherence to sound underwriting standards, timely recognition of loan deterioration, and appropriate loan loss provisioning, as well as (to a limited degree) compliance with consumer protection standards.

In addition to our work at specific institutions, the Federal Reserve also takes a horizontal view of the student loan market across multiple firms during the Comprehensive Capital Analysis and Review (CCAR) exercise, an important supervisory tool that the Federal Reserve deploys, in part, to enhance financial stability by assessing all exposures on bank balance sheets. CCAR was established to ensure that each of the largest U.S. bank holding companies: (1) has rigorous, forward-looking capital planning processes that effectively account for the unique risks of the firm; and (2) maintains sufficient capital to continue operations throughout times of economic and financial stress. The CCAR exercise collects data on banks' student loan portfolios, delineated by loan type (Federal or private), age, FICO Score, delinquency status, and loan purpose (graduate or undergraduate).

The banks submitting student loan data for CCAR held just over $63 billion in both Government-guaranteed and private student loans at year-end 2012, of which $23.6 billion represented outstanding private student loans.[3] At the end of 2012, CCAR banks reported that just over 4 percent of private student loan balances were in delinquency, but more than 21 percent of Government-guaranteed student loan balances were delinquent. Nevertheless, the delinquency rate for Government-guar-

[2] Delinquency status is defined as more than 90 days past due.

[3] Of the 19 banks participating in CCAR, seven submitted student loan data. Sallie Mae, the largest holder of private student loan debt (with $37 billion), is not included in the CCAR data set.

anteed student loans has shown improvement over recent quarters, dropping from a high of more than 23 percent. Likewise, the delinquency rate for private loans at CCAR firms trended upward through mid-2009 but has since moved down, which is comparable to the performance of the overall private student loan market.[4]

The Federal Reserve and the other Federal banking agencies that are members of the Federal Financial Institutions Examination Council (FFIEC) have jointly developed guidance outlining loan modification procedures: the Uniform Retail Credit Classification and Account Management Policy (SR 00–08). This guidance discusses how banks should engage in extensions, deferrals, renewals, and rewrites of closed-end retail loans, which include private student loans. According to that guidance, any loan restructuring should be based on renewed willingness and ability to repay, and be consistent with an institution's sound internal policies.

In keeping with this guidance, the Federal Reserve encourages its regulated institutions to work constructively with borrowers who have a legitimate claim of hardship. The aim of such work should be the development of sustainable repayment plans while also preserving the safety and soundness of the lending institutions and maintaining compliance with supervisory guidance and accounting regulations. When conducted in a prudent manner, modifications of problem loans, including student loans, are generally in the best interest of both the institution and the borrower, and can lead to better loan performance, increased recoveries, and reduced credit risk. Moreover, Federal Reserve examiners will not criticize institutions that engage in prudent loan modifications, but rather will view such modifications as a positive action when they mitigate credit risk. As supervisors, our goal is to make sure that lenders work with borrowers having temporary difficulties in a way that does not contradict principles of sound bank risk management, including reflecting the true credit quality and delinquency status of the loan portfolios.

Implications for Other Forms of Lending

The benefits of higher education are widely recognized and have been supported by public policy initiatives for some time through a variety of State and Federal programs. The fact that annual median earnings are significantly higher for those with higher levels of education is well documented.

However, post-secondary education is becoming increasingly expensive. With continued increases in student debt, and high levels of unemployment, recent graduates are finding it more difficult to repay their obligations, resulting in elevated delinquency and charge-off rates.

Younger borrowers with high student loan balances have reduced their other debt obligations, including credit card, auto, and mortgage debt. This reduction likely reflects in part a decline in demand due to the burden of servicing existing student loans as well as the possibility that access to credit might be curtailed due to high student debt. Borrowers who are delinquent on student debt may face difficulty obtaining other forms of credit. Further, student loan delinquency is also associated with higher delinquency rates on other types of debt. More than 15 percent of delinquent student loan borrowers also have delinquent auto loans, 35 percent have delinquent credit card debt, and just over 25 percent are delinquent on mortgages payments.

Conclusion

Higher education plays an important role in improving the skill level of American workers, especially in the face of rising gaps in income and employment across workers with varying education levels. Due to increasing enrollment and the rising cost of higher education, student loans play an important role in financing higher education. The rapidly increasing burden of student debt underscores the importance of the topic of today's hearing. This concludes my prepared remarks, and I would be happy to answer any questions you may have.

PREPARED STATEMENT OF DOREEN R. EBERLEY

DIRECTOR, DIVISION OF RISK MANAGEMENT SUPERVISION
FEDERAL DEPOSIT INSURANCE CORPORATION

JUNE 25, 2013

Chairman Johnson, Ranking Member Crapo and Members of the Committee, thank you for the opportunity to testify on behalf of the Federal Deposit Insurance

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[4] For all private loans, the delinquency rate increased from 2005 to 2009, and started to decrease during 2010, according to data from Moody's.

Corporation (FDIC) regarding private student loans (PSLs). Higher education has long provided a pathway to prosperity, as individuals with college degrees historically have had higher incomes and lower rates of unemployment than those without. Students and their families have financed higher education through loans, both Federal and private, for many years. While this model works well when graduates are able to obtain employment and use their degrees to move into higher paying jobs, the severity of the recent financial crisis and a relatively slow recovery have resulted in persistently high rates of unemployment and underemployment, which have negatively impacted the newly graduated who are trying to enter or advance through the workforce. Today, many consumers are struggling with student debt loads in a still fragile economic environment.

In my testimony, I will discuss data on the student loan market, including data on its size and performance. I also will discuss our approach to the supervision of private student loan lenders, including the regulations and guidance that apply to private student loans. In addition, I will describe the ability of insured depository institutions (IDIs) to work with consumers to manage their student loan obligations within the current supervisory environment.

In particular, I will describe the FDIC's efforts to communicate to the banks we supervise that, for borrowers experiencing difficulties, prudent workout arrangements are in the best long-term interest of both the bank and the borrower.

Data Regarding Student Loans

Data regarding the overall market for PSLs are difficult to discern because there is no standard source for collecting the data. These data are not broken out separately in the *Consolidated Reports of Condition and Income,* otherwise known as Call Reports, which banks file quarterly, as student lending is a fairly small portion of aggregate consumer lending and relatively few IDIs make these loans. Rather, data on PSLs, like unsecured installment loans, are contained within a broader category called "other loans to individuals."

Nonetheless, based on recent studies, there appear to be about 39 million borrowers with a student loan, with an average balance of about $25,000.[1] As of year-end 2012, total student loans outstanding were about $966 billion.[2] Of this total student loan debt, the Consumer Financial Protection Bureau (CFPB) has estimated the size of the PSL market to be about $150 billion as of year-end 2011, which represents about 15 percent of student loans outstanding, compared to 85 percent for the Federal student loan (FSL) market.[3]

Debt from FSLs and PSLs has risen significantly since 2007, and student loans (FSLs and PSLs combined) are now the largest category of consumer loans, not including first mortgages.[4] With regard to originations, growth has been centered in FSL originations, which have climbed from about $70 billion in the 2006–2007 school year to over $100 billion per year in the past three academic years.[5] In contrast, the PSL market has shrunk considerably over the same time period, with originations peaking at about $23 billion in the 2007–2008 academic year before falling to about $8 billion per year in the past three academic years. In terms of new volumes, PSLs are currently only about 7 percent of overall originations. While the market for PSLs is relatively small, PSLs provide a secondary source of funds for students and families seeking to fill the gap between FSLs and other financial resources and the total cost of students' higher education.

IDIs supervised by the FDIC hold about $14 billion in outstanding PSLs and originated about $4 billion in the 2011–2012 academic year. Reported past due rates (30 days or more delinquent) are just under 3 percent of total student loan balances, and the upper end of the charge-off range is at just over 1.5 percent per year. In addition, IDIs that we supervise are currently requiring cosigners, usually parents, on about 90 percent of the loans they underwrite.

The majority of loans are underwritten at a variable rate of interest, with average interest rates currently in the 6 to 7 percent range. Loan terms vary, usually between 5 and 15 years.

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[1] Donghoon Lee, *Household Debt and Credit: Student Debt,* February 28, 2013, The Federal Reserve Bank of New York Consumer Credit Panel and Equifax, *http://www.newyorkfed.org/newsevents/mediaadvisory/2013/Lee022813.pdf.*

[2] Ibid.

[3] CFPB, *Private Student Loans, Report to the Senate Committee on Banking, Housing, and Urban Affairs, the Senate Committee on Health, Education, Labor, and Pensions, the House of Representatives Committee on Financial Services, and the House of Representatives Committee on Education and the Workforce.* August 29, 2012.

[4] Donghoon Lee, 2013.

[5] College Board Advocacy & Policy Center, *Trends in Student Aid* 2012.

Supervision of PSL Lenders

Of the approximately 4,400 institutions supervised by the FDIC, only a small number of FDIC-supervised institutions originate PSLs, but these include two of the largest PSL originators. Unlike most lending, student lending is complicated by the fact that students often have no established credit history to indicate their creditworthiness, and that repayment will initially be partial, or delayed, often for several years, while the student completes his or her education. Also, PSLs generally are not dischargeable in bankruptcy. While this provides borrowers with a strong incentive to repay, IDIs and other lenders in the PSL market absorb all losses on these loans for borrowers who do not repay, which is why many originators require co-signers.

The FDIC supervises PSL lenders using the same framework of safety and soundness and consumer protection rules, policies, and guidance as for other loan categories. The interagency policy, *Uniform Retail Credit Classification and Account Management Policy* (Retail Credit Policy) applies to student loans as it does to other unsecured personal loans.[6] This policy, which has been in place since 1980, with some subsequent revisions, provides IDIs with guidance on classifying retail credits for regulatory purposes and on establishing policies for working with borrowers experiencing problems.

For safety and soundness purposes, the FDIC examines IDIs to ensure that they are following basic underwriting tenets when extending credit. For PSLs, like all loans, the ability and willingness to repay is necessarily the primary driver of safe and sound lending. Generally, the ability to repay is demonstrated by payments of principal and interest that reduce principal over a reasonable period of time.

During an examination of a PSL lender, FDIC examiners review the appropriateness of the lender's underwriting criteria; loan administration and servicing practices; compliance with applicable laws and regulatory reporting and accounting requirements; loan classification and allowance for loan and lease losses policies; audit and internal review practices; and modification, workout and collection policies and practices. Additionally, examiners review portfolio structure and performance, and related monitoring and controls to assess credit quality and management oversight. They also review individual loan files, on a sampling basis, to ensure consistency with supervisory guidelines, internal bank policies, and overall prudent lending standards.

The FDIC also examines student loan lenders for compliance with applicable Federal consumer protection laws, including the Equal Credit Opportunity Act, the Truth in Lending Act and Regulation Z, the Fair Credit Reporting Act, the Gramm-Leach-Bliley Act rules on privacy of consumer financial information, the Electronic Signatures in Global and National Commerce Act (E-Sign Act), the Service Members Civil Relief Act, and the Community Reinvestment Act (CRA). In addition, Section 5 of the Federal Trade Commission Act, which addresses unfair or deceptive acts or practices, is applicable to this type of lending. As part of these compliance examinations, examiners review policies, procedures, and practices; marketing materials and practices; disclosures provided to borrowers; and any related consumer complaints.

Additionally, examiners review monitoring procedures implemented by the bank to ensure compliance with consumer protection regulations.

Working with Student Loan Borrowers

The FDIC appreciates concerns about repayment and workout options and encourages institutions to work constructively with borrowers who are experiencing difficulty. Examiners will not criticize banks for engaging in alternate repayment plans or modifications so long as such plans or modifications are consistent with safe and sound practices. With respect to workouts and modifications, the interagency Retail Credit Policy specifically states "extensions, deferrals, renewals, and rewrites of closed-end loans can be used to help borrowers overcome temporary financial difficulties." The Retail Credit Policy provides significant flexibility for IDIs to offer prudent workout arrangements tailored to their PSL portfolios. In particular, the policy states that it is the IDI's responsibility to establish its own policies for workouts suitable for their portfolio. Prudent workout arrangements consistent with safe and sound lending practices are generally in the long-term best interest of the financial institution and the borrower.[7]

[6] See *http://www.fdic.gov/regulations/laws/rules/5000-1000.html#fdic5000uniformpf.*

[7] See for example the interagency *Policy Statement on Prudent Commercial Real Estate Loan Workouts,* October 2009, *http://www.fdic.gov/news/news/financial/2009/fil09061a1.pdf* and the interagency *Statement on Working with Mortgage Borrowers,* April 2007, *http://www.fdic.gov/news/news/press/2007/pr07032a.html.*

IDIs supervised by the FDIC offer borrowers experiencing financial difficulties forbearance (cessation of payments) for periods ranging from 3 to 9 months beyond the initial 6-month grace period after leaving school. A number of workout plans are also available to borrowers of FDIC-supervised IDIs, including rate reductions, extended loan terms, and in settlement situations, principal forgiveness. At the same time, it is important that modifications not leave the borrower in a worse position in the long term. For example, a modification that does not provide for payments to cover principal and interest or that allows a loan to remain in extended periods of forbearance can result in negative amortization, which leads to a growing loan balance that can dig a consumer deeper into debt.

Concerns have been raised that troubled debt restructuring (TDR) accounting rules limit IDIs' ability to modify PSLs. The treatment of loans as TDRs is established by generally accepted accounting principles (GAAP), and banks are required by law to adhere to GAAP. Under GAAP, modifications of loans, regardless of loan type, should be evaluated individually, considering all facts and circumstances, to determine if they represent TDRs. A TDR occurs when a lender, due to a borrower's financial difficulties, grants a concession to the borrower that it would not otherwise consider. GAAP requires modified loans that are TDRs to be evaluated for impairment and written down, if necessary, with appropriate adjustments made to the allowance for loan and lease losses.

Potential or actual treatment as a TDR should not prevent institutions from proactively working with borrowers to restructure loans with reasonable modified terms. As stated above, the FDIC encourages banks to work with troubled borrowers and will not criticize IDI management for engaging in prudent workout arrangements with borrowers who have encountered financial problems, even if the restructured loans result in a TDR designation.[8]

It also is important that borrowers who are facing repayment difficulties receive clear and accurate information on opportunities for loan modifications and workouts. There is often a great deal of confusion about differences between FSLs and PSLs. Prior to 2010, FSLs were made through private financial institutions under the Family Federal Education Loan Program, and those loans have more repayment and modifications options than PSLs. The FDIC encourages its institutions to make clear to borrowers the modification and workout options that exist, and the eligibility criteria for such programs.

One complicating factor for modifications of PSLs is that about 25 percent of the estimated $150 billion PSLs outstanding are in securitization trusts.[9] In those cases, payment restructuring and modification options may be limited by the terms of the securitization pooling and servicing agreement. In securitizations, the traditional borrower and lender relationship is replaced by governing documents administered by a trustee for the benefit of multiple parties, including investors. As a result, the servicer and trustee are responsible for ensuring that a securitized pool of loans is managed in the best interest of investors, which substantially limits the ability to change the terms of underlying pooled assets. For example, noteholders may have conflicting incentives based on their seniority in the securitization capital structure, and servicers may not have sufficient legal ability to make modifications without the consent of noteholders or trust administrators. When repayment difficulties arise, the borrower will generally be dealing with the servicer, not the original lender.

Finally, PSL borrowers, especially those who are performing on their loans as agreed, face significant challenges for refinancing higher rate PSLs. Refinancing an unsecured PSL can be difficult given the lack of participants in the refinance market, and the potentially high costs of marketing and customer acquisition that may be keeping additional participants from entering the refinance market. Moreover, many PSLs have variable rates and, in the current low interest rate environment, it may be difficult for consumers to negotiate a lower fixed-rate without collateral.

Additional FDIC Actions

The FDIC continues to seek solutions to challenges in the student lending area. The FDIC is finalizing a statement to the banks it supervises to clarify both that we support efforts by banks to work with student loan borrowers and that our current regulatory guidance permits this activity. In addition, the statement will make clear that FDIC-supervised institutions should be transparent in their dealings with borrowers and make certain that borrowers are aware of the availability of workout

[8] Supra, Footnote 7.

[9] Securities Industry and Financial Markets Association (SIFMA), *U.S. ABS Issuance and Outstanding, http://www.sifma.org/research/statistics.aspx.* This report shows that PSL securitizations outstanding total $37.3 billion.

programs and associated eligibility criteria. We expect to issue this statement in the near future.

We also have formed an internal working group to engage various stakeholders, including PSL lenders and consumer groups, and we are discussing our current policies and refinancing challenges with other regulators, including the CFPB, to determine whether clarifications or changes may be needed.

Conclusion

The FDIC appreciates the opportunity to testify on this important issue. High levels of student debt can pose significant challenges for families, particularly during what has been a prolonged period of high unemployment. The FDIC remains committed to providing focused and effective oversight of institutions engaged in the PSL market to ensure that supervised institutions operate in a safe and sound manner and in compliance with applicable Federal consumer protection laws.

RESPONSE TO WRITTEN QUESTIONS OF CHAIRMAN JOHNSON FROM ROHIT CHOPRA

Q.1. School Certification—The CFPB has recommended mandatory school certification as a way to reduce student debt load and expand loan counseling. Does the Truth in Lending Act give the CFPB the regulatory authority to require school certification of private student loans?

A.1. The Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) transferred the authority to prescribe regulations under the Truth in Lending Act from the Federal Reserve Board of Governors to the Consumer Financial Protection Bureau, including those provisions related to special disclosures for private student loans, which were required by the Higher Education Opportunity Act of 2008 (HEOA).

HEOA required the Department of Education to develop a self-certification form, which private student lenders must obtain before consummating the loan. The Federal Reserve Board of Governors prescribed regulations that detailed requirements for lenders related to the self-certification form.

The self-certification form was intended to spur meaningful conversations between students and school financial aid officials.

In our joint report with the Department of Education on Private Student Loans, the Bureau recommended that Congress require school certification. A number of concerns prompted this recommendation, including how some lenders may be accepting forms that are incomplete or inaccurate. Such incomplete paperwork shows that borrowers may not understand how various loan options have more favorable terms, or whether their loans exceed educational expenses.

The agencies were troubled by the experience of consumers with "direct-to-consumer" private student loans, *i.e.,* loans that had not been "certified" for financial need by the school's financial aid office, were more likely to borrow more than their tuition during the pre-recession boom years. Those loans were also much more likely to end up in default.

Given the recent increase in securitization activity in the private student loan market, the Bureau is monitoring the market closely to determine whether the self-certification process is working as Congress intended. We will continue to consult with members of the public, schools, industry stakeholders, and the Department of Education to determine the appropriate steps to ensure the market is properly functioning.

Q.2. Rural and Economic Impact—Mr. Chopra, the success of rural communities is important to me. Rural areas are facing a serious shortage of qualified professionals in a number of professions, including teaching, medicine, and law. Can you describe the extent to which rising student loan debt could exacerbate existing workforce challenges in rural communities? In your testimony, you also described a "domino" effect of student loans on the economy. Could you expand upon the impacts you found on the ability of borrowers to purchase homes, start businesses, form households, or any other impacts?

A.2. We have heard from consumers and industry professionals that growing levels of student debt may have spillover effects that present particular risks for rural communities. In addition to the fact that for many professions, graduates in rural communities earn less than their peers in more populated metropolitan areas, rural communities tend to have more severe shortages of teachers, certain healthcare providers, and other professionals. The financial strain of high student debt has the potential to exacerbate existing workforce shortages that exist due to these other factors present in rural communities.

I recently had the chance to meet with representatives from the North American Meat Association, the American Veterinary Medical Association, the American Association of Bovine Practitioners, the U.S. Cattlemen's Association, the Academy of Rural Veterinarians, and the National Farmers Union to discuss the potential impact of student debt on farmers, ranchers, and rural communities. Many of these representatives expressed significant concern.

In February 2013, the CFPB published a notice in the *Federal Register* soliciting input on potential solutions to offer more affordable repayment options for borrowers with existing private student loans. According to a submission to the Bureau's request for information from the American Medical Association, high debt burdens can impact the career choice of new doctors, leading some to abandon caring for the elderly or children for more lucrative specialties.[1] Aspiring primary care doctors with heavy debt burdens may be unable to secure a mortgage or a loan to start a new practice. This can have a particularly acute impact on rural America, where rental housing is limited and solo practitioners are a key part of the health care system.

Classroom teachers submitted letters to the Bureau detailing the impact of private student loans, which usually don't offer forgiveness programs and income-based repayment options. One school district official wrote to the Bureau noting that programs to make student debt more manageable could lead to higher retention of quality teachers.[2] In the past decade, we've faced a growing shortage of highly qualified math and science teachers.[3] Rural and urban school districts face particularly severe shortages. And teachers in rural districts generally earn less than their peers—the starting salary for rural teachers is lower than the starting salary for non-rural teachers in 39 States.[4]

Student debt can also impact the availability of other professions critical to the livelihoods of farmers and ranchers in rural communities. According to an annual survey conducted by the American

[1] See *http://www.regulations.gov/#!documentDetail;D=CFPB-2013-0004-0878.*
[2] See *http://www.regulations.gov/#!documentDetail;D=CFPB-2013-0004-0038.*
[3] *http://www.nap.edu/catalog.php?record*_id=11463.
[4] *http://www.eric.ed.gov/ERICWebPortal/search/detailmini.jsp?_nfpb=true&_&ERICExtSearch_SearchValue_0=EJ695458&ERICExtSearch_SearchType_0=0=no&accno=EJ695458.*

Veterinary Medical Association, 89 percent of veterinary students are graduating with debt, averaging $151,672 per borrower.[5] Veterinarians encumbered with high debt burdens may be unable to make ends meet in a dairy medicine or livestock management practice in remote areas.

In effect, young graduates with student debt have less financial flexibility and, consequently, less ability to forgo a better paying job for one in a rural area. The impact of student debt on these communities seems worthy of closer study.

More broadly, we are concerned that student debt may have a "domino effect" on other sectors of the economy. The National Association of Home Builders wrote to the CFPB about the relatively low share of first-time home buyers in the market compared with historical levels, and that student debt can "impair the ability of recent college graduates to qualify for a loan." According to NAHB, high student loan debt has an impact on consumers' debt-to-income (DTI) ratio—an important metric for decisions about creditworthiness in mortgage origination. When monthly student loan payments take up a high portion of a borrower's monthly income, applicants may be less qualified candidates for a mortgage.

The National Association of Realtors noted that first-time home buyers typically rely heavily on savings to fund down payments. When young workers are putting big chunks of their income toward student loan payments, they're less able to save for their first down payment.

We have also heard from a number of young entrepreneurs and innovators working in the technology sector. We asked about the roadblocks they've experienced when trying to build new businesses. For many, student debt has made it much harder to take risks and for these young graduates to bet on themselves and on their ideas. In addition, we've heard that it is challenging to attract talented employees willing to take a risk because they're worried about their debt.

Unfortunately, many recent graduates tell us they've put off their goal of starting a business, and student debt may be playing a role. Since the recession, the share of young graduates' outstanding credit consumed by student loans has jumped by 14 percent. Others have found that young student loan borrowers now have lower credit scores than their peers with no student debt. This may make it more difficult for borrowers to qualify for small business loans.

Other research has demonstrated that three-quarters of the overall shortfall in household formation since the start of the recession can be attributed to reductions in household starts among younger adults ages 18 to 34. In 2011, nearly 2 million more Americans in this age group lived with their parents than in 2007. Moody's Analytics estimates that each new household formed leads to $145,000 of economic impact.

If student debt is holding back just a third of those two million young Americans from living on their own, that adds up to a $100 billion loss or delay in economic activity.

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[5] See *https://www.avma.org/news/journals/collections/pages/avma-collections-senior-surveys.aspx.*

Q.3. Student Loan Servicers—Mr. Chopra, the CFPB recently proposed a rule that would enable it to examine and supervise large student loan servicers. Can you describe why the CFPB proposed this rule and how the agency plans to supervise these servicers?

A.3. In March of 2013, the Bureau issued a proposed rule defining the larger participants in the student loan servicing market. The proposed rule would establish the Bureau's supervisory authority over certain nonbank covered persons participating in the market for student loan servicing. The comment period for the proposed rule closed on May 28, 2013 and the Bureau is considering the comments received before reaching any final decisions on the Proposed Rule.

Student loan servicers play a critical role in the student loan market. Student loan servicers manage interactions with borrowers on behalf of loan holders of outstanding student loans. Servicers receive scheduled periodic payments from borrowers pursuant to the terms of their loans and apply the payments of principal and interest and other such payments as may be required pursuant to the terms of the loans or of the contracts governing the servicers' work. Typically, student loan servicing also involves sending monthly payment statements, maintaining records of payments and balances, and answering borrowers' questions. When appropriate, servicers may also make borrowers aware of alternative payment arrangements such as consolidation loans or deferments.

Student loan servicers also play a role while students are still in school. A borrower may receive multiple disbursements of a loan over the course of one or more academic years. Repayment of the loan may be deferred until some future point, such as when the student finishes post-secondary education. A student loan servicer will maintain records of the amount lent to the borrower and of any interest that accrues; the servicer may also send statements of such amounts to the borrower.

In addition, student loan servicers may collect payments and send statements after loans enter default. They may also report borrowers' account activity to consumer reporting agencies.

In short, most borrowers, once they have obtained their loans, conduct almost all transactions relating to their loans through student loan servicers. The proposed rule would enable the Bureau to supervise larger participants of an industry that has a tremendous impact on the lives of post-secondary education students and former students, as well as their families.

Under 12 U.S.C. 5514, the Bureau has supervisory authority over all nonbank covered persons offering or providing three enumerated types of consumer financial products or services: (1) origination, brokerage, or servicing of consumer loans secured by real estate, and related mortgage loan modification or foreclosure relief services; (2) private education loans; and (3) payday loans. The Bureau also has supervisory authority over "larger participant[s] of a market for other consumer financial products or services," as the Bureau defines by rule. This proposed rule, if adopted, would be the third in a series of rulemakings to define larger participants of markets for other consumer financial products or services for purposes of 12 U.S.C. 5514(a)(1)(B). The Bureau is proposing to establish supervisory authority over certain nonbank covered persons participating in the market for student loan servicing.

The Bureau is authorized to supervise nonbank covered persons subject to 12 U.S.C. 5514 of the Dodd-Frank Act for purposes of: (1) assessing compliance with Federal consumer financial law; (2) obtaining information about such persons' activities and compliance systems or procedures; and (3) detecting and assessing risks to consumers and consumer financial markets. The Bureau conducts examinations, of various scopes, of supervised entities. In addition, the Bureau may, as appropriate, request information from supervised entities without conducting examinations.

The Bureau prioritizes supervisory activity at nonbank covered persons on the basis of risk, taking into account, among other factors, the size of each entity, the volume of its transactions involving consumer financial products or services, the size and risk presented by the product market in which it is a participant, the extent of relevant State oversight, and any field and market information that the Bureau has on the entity. Such field and market information might include, for example, information from complaints and any other information the Bureau has about risks to consumers.

The Bureau plans to supervise these servicers consistent with the general examination manual describing the Bureau's supervisory approach and procedures. This manual is available on the Bureau's Web site. As explained in the manual, examinations will be structured to address various factors related to a supervised entity's compliance with Federal consumer financial law and other relevant considerations. On December 17, 2012, the Bureau released procedures specific to education lending and servicing for use in the Bureau's examinations. If this proposed rule is adopted, the Bureau would use those examination procedures in supervising nonbank larger participants of the student loan servicing market.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR CRAPO FROM ROHIT CHOPRA

Q.1.a. Many of the borrower relief options found in the CFPB's May 2013 report appear beneficial to borrowers. However, one credit reporting agency has a section on its Web site outlining the impact of a loan modification on a borrower's credit report and notes that a modification could negatively impact a credit score.

Has the CFPB done any analysis to determine if there are negative collateral impacts to a borrower who gets a loan modification?

A.1.a. As a general matter, credit scores are based on proprietary models developed by private industry. Based on our discussions with servicers and consumer reporting agencies, there are specific codes in the Metro II reporting format that allow for indicators of alternative repayment plans.

The impact on a credit score of a student loan default would certainly be a negative credit scoring event for an individual consumer. Alternative repayment options that allow a consumer to avoid delinquency and default would potentially lead to a better credit score.

However, if a borrower is current on their obligations and pursues an alternative repayment schedule, a proprietary credit scoring model might determine that this is a sign of distress, which may impact a score.

If financial institutions begin to offer more alternative repayment options to borrowers in distress, it will be important for servicers to clearly explain the factors that should be considered when choosing one of these options.

Q.1.b. How does the CFPB balance the need for a consumer to receive some immediate payment relief with the long term effects on other parts of a borrower's financial profile?

A.1.b. In our consumer engagement efforts, we encourage consumers to think of both the short-term and the long-term. For younger consumers with student loan debt, it is particularly important for borrowers to protect their credit profile. Defaulting on a student loan can make it very difficult to obtain credit in the future, or even pass employment verification checks. We continue to educate consumers on ways to avoid default, such as accumulating emergency savings and pursuing alternative repayment options.

Q.2.a. The CFPB's sole statutory mandate is to protect consumers. Lenders have noted regulatory confusion as the chief obstacle preventing them from offering more borrower relief options. This obstacle arises from a perceived conflict between the Bureau's borrower relief policies and prudential banking regulators' safety and soundness guidance.

Has the Bureau taken steps to ensure that borrower relief options outlined in the May 2013 CFPB report on student loans don't negatively impact the safety and soundness of the private student loan market?

A.2.a. As discussed in the hearing, prudential regulators clearly articulated that they would not criticize institutions for restructuring debt in a safe and sound manner. The Bureau has noted that alternative repayment options for private student loan borrowers might increase the net present value of troubled loans. This would be beneficial both to consumers, financial institution, and investors.

Q.2.b. Did the Bureau work with the prudential banking regulators to address potential regulatory obstacles before publishing the May 2013 report?

A.2.b. The Bureau regularly consults prudential regulators on a wide range of matters, including the development of the May 2013 report. As noted in testimony by the prudential regulators at the June 25th hearing, financial institutions are not barred from restructuring debt, as long as they accurately reflect the value of these loans in their accounting statements.

Q.3.a. As a result of prudential banking regulators offering varying levels of guidance for their supervised institutions with regards to private student loans, the financial institutions may in turn offer varying degrees of borrower relief options.

How does the CFPB anticipate achieving consistent supervision of private student loans made by financial institutions that have different prudential banking regulators and therefore different guidance?

A.3.a. The Bureau does not supervise financial institutions for safety and soundness. The Bureau conducts examinations to assess compliance with Federal consumer financial law. The procedures used in these examinations are available to financial institutions and the public at: *http://files.consumerfinance.gov/f/201212_cfpb_educationloanexamprocedures.pdf.*

RESPONSE TO WRITTEN QUESTIONS OF SENATOR BROWN FROM ROHIT CHOPRA

Q.1. As a voting member agency of the Financial Stability Oversight Council, I am interested in your views on how you assess whether an entity would meet the criteria to be designated a systemically important financial institutions (SIFI). Specifically, given its extremely large footprint in servicing Direct, FFELP, and private student loans, what would be the broader impact on consumers and markets if SLM Corp. (Sallie Mae) were to fail?

A.1. According to its public filings, SLM Corp. (Sallie Mae) services student loans for over 13 million borrowers of Direct, FFELP, and private student loans. According to the surveys by the Student Loan Servicing Alliance, Sallie Mae is the largest servicer in the market, with a commanding lead over its competitors.

Analysis of the impact of an unexpected failure of Sallie Mae would require assessing a number of factors, including whether there would be financial institutions with excess servicing capacity to bid on Sallie Mae's servicing rights and portfolios given a set of capital market conditions, the ability for the Department of Education to reassign Direct Loan volume to other contracted servicers, and the impact of a potential disruption in payments to holders of FFELP asset-backed securities, among others.

If Sallie Mae's failure led to disruptions in servicing, there might also be an impact on the processing of payments and reporting to credit bureaus for individual customer accounts, if appropriate safeguards are not in place.

Q.2.a. In October 2012, the Consumer Financial Protection Bureau issued a report about problems servicemembers face when utilizing benefits guaranteed by Federal law, even on Government-guaranteed student loans. Your agency supervises institutions with FFELP portfolios.

Have you focused on these portfolios in your examinations?

A.2.a. Prior to 2010, many insured depository institutions originated student loans guaranteed by the Federal Government. For insured depository institutions with assets over $10 billion and their affiliates, the authority to supervise such entities for compliance with Federal consumer financial law transferred from prudential regulators to the CFPB on the Dodd-Frank Act transfer date. The Department of Education oversees compliance with Title IV of the Higher Education Act.

Our supervision program to date has covered a range of student lending issues, as well as other lending issues servicemembers are facing. The October 2012 report you reference detailed difficulties many servicemembers face in managing student loan debt, despite a number of Federal protections and benefits for servicemembers to help manage their student loan debt.

Under the CFPB's procedures for student lending examinations, examiners assess a variety of issues. The full procedures are available to the public at: *http://files.consumerfinance.gov/f/201212_cfpb_educationloanexamprocedures.pdf.*

During the course of the examination, examiners may find evidence of violations of—or an absence of compliance policies and procedures with respect to—laws such as the Servicemembers Civil Relief Act. Additionally, examiners assess servicers' policies and procedures for granting deferments consistent with FFELP requirements. The CFPB follows up on any examination findings as appropriate, depending on all of the facts.

Q.2.b. To what extent have you determined that servicemembers are victims of unfair or deceptive practices as it regards to student loan benefits?

A.2.b. An important function of the Bureau's Office of Servicemember Affairs is to "monitor complaints by servicemembers and their families." Over the course of reviewing these complaints, it became clear that servicemembers were experiencing difficulties obtaining and retaining their SCRA rights, as well as other benefits. The complaints submitted by servicemembers and their families regarding their experiences with financial institutions when navigating student loan repayment options were quite distressing. These complaints raise serious questions about the commitment of certain financial institutions to comply with laws that protect military families.

The CFPB articulated these concerns as part of the October 2012 report and will utilize the tools at its disposal to ensure that consumer protections relating to consumer financial products and services are vigorously enforced for servicemembers, veterans, and their families. Former Secretary of Defense Leon Panetta also shared his concern about misleading information given to servicemembers at an announcement discussing the findings of the report.

Some financial institution investors have expressed surprise that senior management would be willing to bear significant reputation risk for a relatively minor level of additional profit on servicemember student loans.

Q.2.c. Are you confident that your supervised institutions are in compliance with the SCRA?

A.2.c. The October report laid out serious concerns over apparent compliance issues as they relate to student lending and the SCRA. The CFPB continues to remain concerned about active-duty servicemembers obtaining and retaining their rights under the SCRA.

Q.2.d. To what extent have you shared these results with the Department of Education and the Department of Justice?

A.2.d. The Dodd-Frank Act contemplates that the Office of Servicemember Affairs will coordinate with other Federal and State agencies "regarding consumer protection measures relating to consumer financial products and services offered to, or used by, servicemembers and their families." The CFPB has worked closely with both the Department of Education and the Department of Justice as it relates to military student loan issues and the significant consumer protection risks documented within the October report.

Q.3.a. Much of the testimony focused heavily on forbearance as a method of relief for private student loan borrowers. But the volume and terms of private student loans issued in the years leading up to the financial crisis indicate that many of these loans may not be sustainable even after forbearance periods. Your July 2012 report documented a 400 percent increase in the volume of private student loan debt originated between 2001 and 2008—and 2008 originations surpassed $20 billion. The report also shows that from 2005 to 2008 undergraduate and graduate borrowers of private student loans took on debt that exceeded their estimated tuition and fees, and in some years more than 30 percent of loans were made directly to students with no certification of enrollment from their academic institution. The heavy debt burden that was created in these few years is not just unsustainable by dollar volume, but also in the loans' terms. Loans were often variable rate loans with initial interest rates ranging from 3 percent to more than 16 percent.

Given that these unfavorable loan terms were made to a larger number of borrowers, presumably including more students from limited financial means, do loans originated between 2001 and 2008 comply with your standards for safety and soundness?

A.3.a. Many private student loan borrowers wish to repay their loans but are seeking alternative repayment plans when they are unable to earn sufficient income to meet minimum required payments. The joint CFPB–ED Report to Congress on Private Student Loans found that, in 2008, 10 percent of private student loan borrowers devoted more than 25 percent of their income to meet student loan repayment obligations—a figure that may have risen as labor market conditions worsened. Many struggling borrowers end up in delinquency or default, see their credit profile damaged, and may be excluded from full economic participation once they attain adequate employment.

However, the CFPB does not supervise institutions, including private student loan lenders, for safety and soundness standards. This responsibility remains with the prudential regulators, so the CFPB cannot speak to whether loans with poor underwriting met these standards.

Q.3.b. How would refinancing the highest-cost loans to reflect borrowers' current characteristics affect the soundness of a regulated institution's balance sheet in the short and long term?

A.3.b. The CFPB does not supervise institutions for safety and soundness regulations, so it would be difficult for the CFPB to determine this impact. As a general matter, when pricing is not commensurate with risk profile, this may be a sign of insufficient competition.

Q.4.a. It has often been noted that the lack of competition in the private student lender market has limited loan refinancing opportunities.

Given the lack of competition in this space, how can we assure that low- and middle-income students have access to affordable loans and loan modification options that reflect the borrower's characteristics and ability and willingness to repay?

A.4.a. Borrowers from low- and middle-income families might face high prices on private student loans due to their cosigners' credit profile. Even when these borrowers graduate and find good jobs, many report to the Bureau that they are unable to refinance to lower rates that reflect their reduced credit risk. The current industry structure may not be delivering efficient pricing, and this may warrant further action from policymakers.

Q.4.b. Is there an existing public or private mechanism to encourage more sustainable loan terms and refinancing opportunities for student borrowers?

A.4.b. As discussed in the hearing, depository institutions are able to offer affordable payment plans to borrowers, as long as they accurately reflect the value of the loans. However, loan restructuring activity is troublingly low.

Policymakers took a number of steps to jumpstart lending and capital markets activity as the financial crisis began to unravel. This might provide valuable lessons for how to ensure a well-functioning student loan market.

Q.4.c. Without intervention from Congress or regulators, is there reason to believe that private student lenders will actively work with borrowers to issue more sustainable loans and to modify the terms of loans issues prior to the financial crisis to more accurately reflect the risk profile of the borrower given the current lending environment and their financial status?

A.4.c. Lenders who are nimble and seek to maximize shareholder value would likely modify loan terms for distressed borrowers in order to avoid losses from default. However, many financial institutions face significant challenges with legacy accounting, IT, and servicing systems that are complex, inhibiting this activity.

Q.5. Pursuant to Section 1035 of the Dodd-Frank Act, you have regularly executed the mandate to provide "appropriate recommendations" to certain Congressional committees. Congress has been examining the long-term future of the GSE participants in the housing market. Given your expertise in the student loan market and your statutory mandate, would you find it appropriate to provide policymakers with your assessment of Sallie Mae's transition from a GSE to its current corporate form to inform our approach on housing GSE policy? If so, what might be a feasible timeline?

A.5. As chartered, the mission of the Student Loan Marketing Association (Sallie Mae) was to provide liquidity for Government-guaranteed student loans and serve as a national secondary market and warehousing facility. Next year will be the tenth anniversary of the termination of Sallie Mae's Government charter. As part of the privatization, the Federal Government freed the company of many of its requirements as a GSE and permitted the company to maintain the Sallie Mae brand for a fee of $5 million.

While Sallie Mae is now a private company (organized as SLM Corp), its business model is closely tied to Government programs. For example, Sallie Mae is a major Government contractor where it acts as a servicer and debt collector for Federal Direct Loans.

The corporation is a large holder of FFELP loans, where it receives certain subsidies on interest accruals from the Federal Government. According to its filings, Sallie Mae has relied on Government-affiliated financing, including an asset-backed commercial paper facility arranged by the Department of Education and a line of credit with a Federal Home Loan Bank through its insurance subsidiary. The corporation also operates Sallie Mae Bank, whose deposits are insured by the FDIC.

The Department of the Treasury's Office of Sallie Mae Oversight served as the GSE's primary regulator. The Bureau and the Department of Education now maintain significant compliance oversight responsibilities over many of Sallie Mae's business activities (and in some cases, the Department of Education has contractual oversight). The Bureau is involved in frequent dialogue with the Departments of Education and Treasury about the activities of Sallie Mae, given its outsized role in the student loan market.

In upcoming months, I will gather further information from appropriate agencies, as well as former OSMO staff, to provide information to your office and other interested parties about the privatization of the GSE and its impact on the marketplace.

Q.6.a. A key finding of the Senate HELP Committee report, "For Profit Higher Education: The Failure to Safeguard the Federal Investment and Ensure Student Success" is that some for-profit schools are engaged in tactics that appear designed to manipulate rates of students defaulting on loans. This includes schools paying staff based on the number of forbearances or deferments secured, and in at least one instance paying private investigators to get signed forbearance authorizations.

Has the CFPB seen similar tactics in the private student loan market?

A.6.a. The Bureau is unable to comment on the status or existence of any investigation of for-profit colleges as it relates to tactics used to manipulate default rates.

As a general matter, for-profit colleges do not face consequences under the Higher Education Act for defaults experienced by students on their private student loans. The Higher Education Act specifies that for-profit colleges may not exceed certain cohort default rates on Federal student loans without risking eligibility for accepting Title IV funds.

Q.6.b. Has the CFPB seen evidence that particular institutions with high levels of student defaults (upwards of 15 percent) are focused on enrolling servicemembers?

A.6.b. According to data from the Departments of Veterans Affairs and Education, of the 75 schools with the most recipients of GI Bill beneficiaries, more than half of those institutions have a default rate over 15 percent.

Q.6.c. Has the CFPB seen evidence that institutions that enroll a high number of servicemembers also have a large number of students that are taking out private student loans?

A.6.c. The Bureau is unable to comment on the status or existence of any investigation of for-profit colleges targeting servicemembers and steering them to private student loans.

However, there is concern that the incentive structure created by the "90–10 rule" encourages for-profit colleges to aggressively market to servicemembers, due to the requirement that for-profit colleges get at least 10 percent of their revenue from sources other than Title IV Federal education funds administered by the Department of Education. GI Bill and Military Tuition Assistance benefits are not Title IV funds, so they fall into the 10 percent category that these colleges need to fill—and we have heard of some very aggressive tactics to quickly enroll GI Bill recipients, who also took out private student loans to pay for the amount of tuition and fees not covered by military benefits.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR MANCHIN FROM ROHIT CHOPRA

Q.1. In rural towns across the country, there is a chronic shortage of primary care health professionals. Not just doctors, but nurses and others. According to the American Medical Association, student debt may be a barrier to practicing in underserved communities. This problem extends beyond health professionals. I hear from West Virginians across my State that the best teachers are retiring and that poorer districts are having a tough time bringing in young people to take their places. So many rural families want their kids to go to college, but they worry about the impacts of high levels of student loan debt? In your opinion, how will rural areas survive without critical professions like doctors, nurses, and teachers? What are you doing to make sure that the burden of student debt isn't disproportionately shouldered by rural areas?

A.1. As you have observed in West Virginia, we have heard from consumers and the agriculture industry that growing levels of student debt may have spillover effects that present particular risks for rural communities. If critical professions such as doctors, nurses, and teachers are unable to locate in rural areas, this could pose a serious threat to the standard of living for Americans in rural communities.

I recently had the chance to meet with representatives from the North American Meat Association, the American Veterinary Medical Association, the American Association of Bovine Practitioners, the U.S. Cattlemen's Association, the Academy of Rural Veterinarians, and the National Farmers Union to discuss the potential impact of student debt on farmers, ranchers, and rural communities. Many of these representatives expressed significant concern.

In addition to the fact that for many professions, graduates in rural communities earn less than their peers in more populated metropolitan areas, rural communities tend to have more severe shortages of teachers, certain healthcare providers, and other professionals. The financial strain of high student debt has the potential to exacerbate existing workforce shortages that exist due to these other factors present in rural communities.

In February 2013, the CFPB published a notice in the Federal Register soliciting input on potential solutions to offer more affordable repayment options for borrowers with existing private student loans. According to a submission to a Bureau request for information from the American Medical Association, high debt burdens can impact the career choice of new doctors, leading some to abandon caring for the elderly or children for more lucrative specialties.[1] Aspiring primary care doctors with heavy debt burdens may be unable to secure a mortgage or a loan to start a new practice. This can have a particularly acute impact on rural America, where rental housing is limited and solo practitioners are a key part of the health care system.

Classroom teachers submitted letters to the Bureau detailing the impact of private student loans, which usually don't offer forgiveness programs and income-based repayment options. One school district official wrote to the Bureau noting that programs to make student debt more manageable could lead to higher retention of quality teachers.[2] In the past decade, we've faced a growing shortage of highly qualified math and science teachers.[3] Rural and urban school districts face particularly severe shortages. In effect, the communities with the most urgent need for great teachers tend to be the school districts with the fewest. And teachers in rural districts generally earn less than their peers—the starting salary for rural teachers is lower than the starting salary for nonrural teachers in 39 States.[4]

Student debt can also impact the availability of other professions critical to the livelihoods of farmers and ranchers in rural communities. According to an annual survey conducted by the American Veterinary Medical Association (AVMA), 89 percent of veterinary students are graduating with debt, averaging $151,672 per borrower.[5] Veterinarians encumbered with high debt burdens may be unable to make ends meet in dairy medicine or livestock management practices in rural communities.

In effect, young graduates with student debt have less financial flexibility and, consequently, less ability to forgo a better paying job for one in a rural area. The potential impact of student debt on these communities is one that policymakers should closely monitor.

Q.2. It does not make any sense that, under our current system, students are forced to pay high interest rates on Federal student loans when everyone else in the economy benefits from low borrowing costs on everything else. And if we don't act by July 1st, every Federal loan will have an interest rate of at least 6.8 percent in 2013, while T-bill rates stay near historic lows. Not only would moving to a market-based rate allow students to benefit from cheaper borrowing when everyone else can, I expect that private student loan lenders would, in order to remain competitive, lower their rates as well. Under the current system, private lenders know that we have created artificial benchmarks for these rates, so private lenders can always keep their rates unnecessarily high. How do you believe that implementing a market-based rate for Federal loan programs would affect the private loan market? Wouldn't allowing Federal rates to fall during times of cheap borrowing—such

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[1] See *http://www.regulations.gov/#!documentDetail;D=CFPB-2013-0004-0878.*

[2] See *http://www.regulations.gov/#!documentDetail;D=CFPB-2013-0004-0038.*

[3] *http://www.nap.edu/catalog.php?record__id=11463.*

[4] *http://www.eric.ed.gov/ERICWebPortal/search/detailmini.jsp?__nfpb=true&__&ERICExtSearch__SearchValue__0=EJ695458&ERICExtSearch__SearchType__0=0=no&accno=EJ695458.*

[5] See *https://www.avma.org/news/journals/collections/pages/avma-collections-senior-surveys.aspx.*

as today—force private borrowers to lower their interest rates to remain competitive?

A.2. As a general matter, the student loan market has not exhibited signs of robust competition—even when private market participants dominated. In the Federal Family Educational Loan Program, financial institutions could receive subsidies and guarantees if loans met certain criteria. Congress set statutory interest rate caps; in theory, the most efficient private actors would attract customers by providing the lowest possible price on a commodity product.

Unfortunately, this was generally not the case. While lenders made limited use of incentives, such as waivers of some origination fees, those who charged the statutory maximum were not competed out of the market. Even when borrowers were offered various advertised incentives, many borrowers would never benefit from those incentives. Instead of offering competitive prices to student loan borrowers, many financial institutions drew scrutiny for business models that provided benefits to schools and financial aid officials, who are able to strongly influence student loan choices by students and families.

The Department of Education and the Bureau authored a joint report to Congress on private student loans, which showed that most borrowers would be better off exhausting Federal student loan options before choosing private loans. Given that private student loans and Federal student loans are not economic substitutes, it would be difficult to determine how Federal student loan rates might impact private student loan pricing.

RESPONSE TO WRITTEN QUESTIONS OF CHAIRMAN JOHNSON FROM JOHN C. LYONS

Troubled Debt Restructuring

Q.1.a.–d. Many lenders have noted that they cannot modify loans because they do not want the modification to be considered a troubled debt restructuring, or TDR, for accounting purposes. Mr. Lyons' testimony stated that "under GAAP a bank must recognize a loan modification for a financially troubled borrower that includes concessions as a TDR, with appropriate loan loss provisions if impairment exists. The designation of a loan as TDR does not prohibit or impede a bank's ability to continue to work with the borrower." Ms. Eberley's testimony noted that "[p]otential or actual treatment as a TDR should not prevent institutions from proactively working with borrowers to restructure loans with reasonable modified terms . . . [t]he FDIC encourages banks to work with troubled borrowers and will not criticize IDI management for engaging in prudent workout arrangements with borrowers who have encountered financial problems, even if the restructured loans result in a TDR designation."

Q.1.a. Can you describe when a loan modification is a TDR and what role your agency plays in interpreting the accounting standard?

A.1.a. A troubled debt restructure is a restructuring in which a bank, for economic or legal reasons related to a borrower's financial difficulties, grants a concession to the borrower that it would not otherwise consider. Modification of the loan terms, such as a reduction of the stated interest rate or an extension of the maturity date at a stated interest rate lower than the current market rate for new debt with similar risk, typically qualifies as a restructuring under financial and regulatory reporting requirements.

The standards for applying TDR accounting are set by the Financial Accounting Standards Board (FASB) and are part of generally accepted accounting principles (GAAP). A bank's call report is statutorily required to be no less stringent than GAAP. As a result, the OCC ensures that modified or restructured loans are properly identified, risk-rated, accounted for, and reported to maintain the integrity of financial reporting. This includes the identification of troubled debt restructurings and a complete analysis of the allowance for loan and lease losses related to loan modification efforts. The OCC and other Federal banking agencies also provide input to the FASB on GAAP issues, including TDRs. For example, in an interagency comment letter to the FASB on the credit loss proposal dated May 31, 2013, the agencies encouraged the FASB to consider alternatives to the TDR designation requirements such as targeted or expanded disclosures.

Q.1.b. Can you describe how designation of loans as TDR factors into an institutions' allowance for loan and lease losses (ALLL), and what role the ALLL plays in calculation of a financial institution's minimum regulatory capital?

A.1.b. All loans whose terms have been modified in a troubled debt restructuring must be evaluated for impairment under Accounting Standards Codification (ASC) Topic 310, Receivables. In general, loans are impaired when, based on current information and events, it is probable that an institution will be unable to collect all amounts due (*i.e.,* both principal and interest) according to the contractual terms of the original loan agreement. Impaired loans require appropriate financial statement recognition either through charge-off or ALLL reserve allocations.

When measuring TDR impairment on an individual loan basis, a bank must choose one of the following methods:

- The present value of expected future cash-flows discounted at the loan's effective interest rate (*i.e.,* the contractual interest rate adjusted for any net deferred loan fees or costs, premium, or discount existing at the origination or acquisition of the loan);
- The loan's observable market price; or
- The fair value of the collateral, if the loan is collateral dependent.

For most private student loans, the present value of expected future cash-flows is used to evaluate impairment. For practical reasons, pools of smaller-balance homogeneous TDRs could be reviewed on a pooled basis. If the impaired value is less than the current book value, the deficiency is typically recognized by adjusting the ALLL. When available information confirms that a specific restructured loan (or portion) is uncollectible, the uncollectible amount should be charged off against the allowance for loan and lease losses at the time of restructuring.

For regulatory capital purposes, treatment of the allowance for loan and lease losses is different under the generally applicable rules and the advanced approaches rules. For the generally applicable rules, the allowance is included in tier 2 capital, up to a maximum of 1.25 percent of riskweighted assets. A bank may deduct from its risk-weighted assets the portion of its reserves for loan and lease losses that exceed the 1.25 percent maximum. For the advanced approaches rules, banks are required to compare eligible credit reserves to expected credit losses. If a shortfall exists, the bank must deduct the shortfall amount from capital (50 percent from tier 1 capital and 50 percent from tier 2). In contrast, if eligible credit reserves exceed the bank's total expected credit losses, the bank may include the excess amount in tier 2 capital to the extent that the excess amount does not exceed 0.6 percent of the bank's credit-related risk-weighted assets.

Q.1.c. How would the Basel III rules change the treatment of ALLL in the capital calculation, if at all?

A.1.c. The Basel III rules are similar to Basel II with respect to the treatment of the ALLL. There are two small changes. The first is that the base of calculating the amount of ALLL that would be included in tier 2 capital under the standardized approach, which will become the generally applicable rule in 2015, no longer includes market risk-weighted assets for banks subject to the market risk capital rule. The second change applies to the advanced approaches rules and specifies that any shortfall of reserves (when compared to expected losses) will be deducted entirely from common equity tier 1. Previously, the shortfall was deducted 50 percent from tier 1 and 50 percent from total capital.

Q.1.d. Please describe any other impact designating a loan as TDR has on an institution's balance sheet.

A.1.d. National banks and Federal thrifts should also evaluate consumer loan TDRs to determine whether accrual of interest remains appropriate. In accordance with call report instructions, upon restructure, a current, well-documented credit evaluation of the borrower's financial condition and prospects for repayment must be performed to assess the likelihood that all principal and interest payments required under the modified terms will be collected in full. Nonaccrual reporting status for individual consumer loans is not specifically required, but the institution must take steps to ensure that net income is not materially overstated.

Guidance

Q.2.a.–c. Mr. Lyons stated in his testimony that the OCC issued supplemental guidance to its examiners in 2010 interpreting the Uniform Retail Classification and Account Management Policy (Retail Policy) in the context of private student lending. However, that guidance is not available to private student lenders, borrowers, or any other market participants.

Q.2.a. Does the OCC plan to make this guidance public or otherwise provide information to the institutions that it regulates on supervisory expectations for managing forbearance, workout, and modification programs?

A.2.a. The guidance was distributed to all examiners, and has been discussed internally with each bank during the normal examination cycle that included a review of private student lending activity.

In July 2013, the OCC issued a reminder to national banks and Federal thrifts of the importance of working constructively with troubled student borrowers to avoid unnecessary defaults. It reminded lenders that prudent workout arrangements are consistent with safe and sound lending practices and are generally in the long-term best interest of both the financial institution and the borrower. To promote consistency, this was a joint agency announcement by the OCC, Federal Reserve, and the Federal Deposit Insurance Corporation (FDIC).

Q.2.b. Mr. Vermilyea stated in his testimony that the Retail Policy is "timeless." The Retail Policy was revised in 2000, which superseded a 1999 revision, which in turn revised a policy from 1980. The private student loan market quadrupled from 2001 to 2008 and just as rapidly declined through 2012.

Given the marked changes in the student loan market since publication of the Retail Policy in 2000, what criteria do the agencies, either individually or through the Federal Financial Institutions Examination Council, use to determine when it is appropriate to revisit retail credit policy?

A.2.b. The agencies review the Uniform Retail Classification and Account Management Policy (Uniform Classification Policy) for updating or clarification when it becomes apparent that lending practices are changing and application is inconsistent or unclear. The main criteria would be if product terms change significantly enough that the delinquency-based foundation would no longer serve as a reasonable credit quality proxy. This would be most likely if regular, required monthly payments were no longer sufficient to signal a borrower has continued willingness and ability to repay the debt as structured.

This becomes apparent to the agencies through examination work, policy-application questions from bankers or examiners, and general monitoring of lending practices and trends. Most consumer products continue to fit reasonably well under the Uniform Classification Policy parameters.

Q.2.c. When would it be appropriate to provide guidance to private student lenders regarding supervisory minimum expectations?

A.2.c. It becomes most important to provide guidance to lenders when product terms change significantly, application of existing policies is inconsistent, or the nature of specific products makes application of existing guidance unclear. For private student loans, the nature of the transition from school to full-time employment is unique to the product and warranted special consideration. Given the economic conditions in 2010, the OCC determined that establishing parameters for initial grace periods and the prudent use of forbearance programs would help lenders apply the Uniform Classification Policy more consistently.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR CRAPO FROM JOHN C. LYONS

Q.1. In 2010, the OCC published additional guidance for financial institutions so they may properly record private student loan modifications on their books. The OCC currently allows financial institutions the ability to offer borrowers a 6-month grace period after graduation and a 6-month forbearance period. This guidance effectively grants the institution the ability to offer a 1-year window before a borrower has to make full payment.

What factors did the OCC consider in publishing additional guidance on private student loans?

A.1. The primary factor the OCC considered concerned the difficulty borrowers were having in the transition from school to the job market once their education was complete. The job market in 2010 was extremely difficult for students, and many had problems finding full-time employment in their specific field of study. Most student loan structures provide a 6-month grace period to help borrowers find suitable employment, but many borrowers found this an insufficient amount of time and were having difficulty beginning scheduled payments.

In response, some lenders began granting excessive forbearance to distressed borrowers both in the transition to repayment and during the repayment term. The most common was the suspension of all payments for protracted periods without sufficient analysis or documentation of the borrower's hardship or willingness and reasonably expected ability to repay. This was inconsistent with the fundamental principles of the Uniform Classification Policy that allows extensions, deferrals, renewals, and rewrites to help borrowers overcome temporary financial difficulties. Under the Uniform Classification Policy, prudent forbearance programs are allowed so long as the actions do not cloud the true performance and delinquency status of the portfolio, are based on renewed willingness and ability to repay the loan, and are structured and controlled in accordance with sound internal policies and procedures. In this case, the OCC determined that additional contextual guidance would improve consistency. The main purpose of the additional guidance was to describe practices that would generally be acceptable as part of a controlled and documented program, including grace and extended grace periods, loan modifications, and in-school deferments.

Q.2. What factors contributed to the OCC's decision to cap the grace period and forbearance period at 6 months each?

A.2. The initial 6-month grace period is a common industry practice for most student loans, public and private. This initial period has traditionally been sufficient to allow borrowers time to find employment, and adjust to the costs of establishing households and other expenses of independent living. Extended grace periods were a direct response to the difficulties students had finding fulltime employment given the economic conditions at the time.

The extended grace period was capped at an additional 6 months (12 months in total) to balance a reasonable job search timeframe with the need for institutions to maintain the integrity of their financial statements. The nature of the school-to-work change makes a transition period appropriate, but accurate reporting is also an important risk management practice that protects the integrity of the financial statements, and prompts direct and active loss mitigation actions when necessary. Both factors were considered in the allowable grace and forbearance timeframes.

Q.3. It is possible that a 2-year graduated repayment option actually results in better performance of the loan than a 1-year window of no repayment. Why is a 2-year graduated repayment option not allowed under current OCC guidance?

A.3. It is possible that a 2-year graduated repayment plan could result in better performance than a 1-year window of no repayment. Regular payments are an important characteristic of well-structured, successful consumer loan products, and the sooner a borrower with capacity begins making payments, the more likely they will manage their overall financial situation in a prudent and disciplined manner. Limited grace periods can help borrowers with the initial transition from school to full-time employment, but in general, the longer forbearance lasts, the more expensive the loan becomes and the more likely it is that borrowers may allocate available funds to other priorities. That is why many successful private student loan programs offer borrowers the option of making some payments each month even while in school. It lowers long-term costs (by reducing or eliminating deferred interest) and helps the borrower manage their budget and get used to making regular payments on the debt. Sometimes zero payment grace and deferral periods are necessary for borrowers without the capacity to repay, but we would not be surprised if accounts with immediate regular payments, even if initially lower than full, amortizing payments, outperformed loans with extended grace and forbearance periods.

The OCC's guidance does not prohibit appropriately structured graduated repayment plans as a type of loan modification. More specifically, our guidance does not specifically address graduated repayment options of any time period because if a borrower is not able to make the full payment the bank has the option to consider a modification or workout plan that best fits the individual consumer's situation. This modification or workout plan could result in a period of full deferral or, depending on the consumer's ability to pay, a period of lower payments until the borrower is able to resume full regular payments.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR BROWN FROM JOHN C. LYONS

Q.1.a.–b. In the years leading up to the financial crisis, the Student Loan Asset Backed Securities (SLABS) market experienced unprecedented growth. SLABS issuance grew to more than $16 billion annually to feed investor demand for these securities. To increase volume, higher dollar value loans were made to a greater range of borrowers before being securitized. Multiple witnesses noted that the loans still held in securitized trusts may have fewer modification and refinance opportunities than those retained on a bank's balance sheet, further limiting options for borrowers and raising the risk of default.

Q.1.a. Where applicable, what percentage of student loans originated by institutions regulated by your agency and still in repayment is held in securitized trusts? What percentage is held on banks' balance sheets?

A.1.a. The largest OCC-regulated institutions with student lending portfolios have outstanding balances aggregating approximately $55 billion. Of that, approximately $4.9 billion or 9 percent is held in securitized trusts, with the remaining 91 percent on balance sheet.

Q.1.b. Is there a difference in the performance of loans that have been securitized and those that are held directly on a bank's balance sheet?

A.1.b. Performance metrics for the securitized balances, in some cases, are better than those for loans that are not securitized. The primary reason for this is that in some of our institutions that have exited private student lending, securitized assets have seasoned, with all of the loans well into their repayment period. These loans are generally beyond the time in their life cycle when most delinquencies and losses are likely to occur.

Q.2.a.–c. In his testimony, Mr. Chopra stated that mortgage and student loan borrowers may have more difficulties working out a modification or forbearance when those loans have been securitized, but fewer barriers exist for student loan borrowers than existed in the mortgage market.

Q.2.a. What additional barriers to forbearance and modifications exist for private student loan borrowers whose loans were securitized?

A.2.a. The main limitation is generally aggregate forbearance and modification levels for the securitized pool as a whole. Frequent modification and forbearance actions can reduce portfolio yield and extend loan maturity enough to disrupt the timing and level of the securities' cash-flows that investors are expecting. Rating agencies monitor and stress forbearance and modification actions to track whether volumes are higher than expected or could potentially impair cash-flows available for investors. Cash flow interruptions from unexpected forbearance or modification levels could result in a ratings downgrade. As volumes near thresholds, servicers may have contract or financial incentives to reduce the volume of modification and forbearance activity.

Q.2.b. How are contract conditions for SLABS different from conditions for mortgage-backed securities?

A.2.b. Contracts vary, but the general parameters for most asset-backed securities are similar. For example, most SLABS and mortgage-backed securities (MBS) require servicers to manage, service, administer and make collections on trust assets with reasonable care, using the degree of skill and attention that the servicer exercises with similar loans that it services on its own behalf. In other words, the contracts generally expect servicers to treat securitized accounts the same way they treat their own.

Investors, trustees, and rating agencies prefer common servicing approaches because cash-flow estimates for the securitized pools are largely based on an issuer's/servicer's pattern of performance.

Past performance is an important factor in setting pricing and credit enhancement levels, two factors that significantly affect price. Long, consistent history allows better analysis and cash-flow projections as long as borrower pools remain reasonably stable. Even so, both contract types also typically limit aggregate forbearance or modification activity to levels unlikely to alter projected cash-flows materially without explicit written trustee consent. Trustees want consistent performance, but also wish to retain some control over actions that could change cash-flows enough to affect a securities rating.

In some cases, the existence of collateral and the lack of bankruptcy protection in a mortgage transaction may prompt MBS to give servicers more flexibility than student loan securities. Proactively managing collateral and secondary sources of repayment can materially affect trust cash-flows, so MBS pooling and servicing contracts may allow more frequent or timely forbearance or modification actions. For example, some contracts allow MBS servicers to modify loans when default is "imminent" rather than the more common post-default threshold. Since private student loans seldom have collateral but do have long-term protection from bankruptcy discharge, different loss mitigation approaches are common.

Q.2.c. What would be required to offer borrowers with securitized loans the same options that can be afforded to borrowers whose loans were not securitized?

A.2.c. Most contractual forbearance and modification limitations for securitized assets are designed to ensure adequate and timely cash-flows to repay investors. The most compelling argument for allowing greater activity would be to convince investors (and rating agencies) that the forbearance and modification actions used objectively improve the timing and amount of cash-flows received, and do not simply defer losses. Investors are particularly wary of speculative modification actions that only delay losses since security structures sometimes release credit protection over time, and delayed (rather than reduced) losses may then occur when credit protection is no longer available.

Q.3. As a voting member agency of the Financial Stability Oversight Council, I am interested in your views on how you assess whether an entity would meet the criteria to be designated a systemically important financial institutions (SIFI). Specifically, given its extremely large footprint in servicing Direct, FFELP, and private student loans, what would be the broader impact on consumers and markets if SLM Corp. (Sallie Mae) were to fail?

A.3. The Financial Stability Oversight Council (FSOC) has established a three-stage process and interpretative guidance that FSOC members use to assess and determine whether a nonbank financial company should be designated as systemically important and subject to enhanced prudential standards and supervision by the Board of Governors of the Federal Reserve System pursuant to section 113 of the Dodd-Frank Act. The FSOC's assessment process considers the 10 statutory considerations set forth by Congress for making such determinations. FSOC's interpretative guidance evaluates these factors in the context of how the material distress at a given nonbank financial company could be transmitted to other financial firms and markets and thereby pose a threat to U.S. financial stability through three transmission channels:

(1) the exposures of creditors, counterparties, investors, and other market participants to the nonbank financial company;
(2) the liquidation of assets by the nonbank financial company, which could trigger a fall in asset prices and thereby could disrupt trading or funding in key markets or cause significant losses or funding problems for other firms with similar holdings; and
(3) the inability or unwillingness of the nonbank financial company to provide a critical function or service relied upon by market participants and for which there are no ready substitutes.

Thus, consistent with the FSOC's interpretative guidance, factors that one would consider when assessing the potential impact of a failure by any nonbank financial company, include substitutability (*e.g.,* the extent to which there would be other sources for products or services offered by the nonbank financial company); interconnectedness between the nonbank financial company and other financial institutions; and the complexity and resolvability of the nonbank financial company's operations.

Q.4.a. In October 2012, the Consumer Financial Protection Bureau issued a report about problems servicemembers face when utilizing benefits guaranteed by Federal law, even on Government-guaranteed student loans. Your agency supervises institutions with FFELP portfolios.

Have you focused on these portfolios in your examinations?

A.4.a. Most large banks do not offer private student lending. However, when offered, the Servicemembers Civil Relief Act (SCRA) is an integral part of OCC's compliance supervision. Supervisory activities include a review of internal audit processes and findings as well as bank policies, procedures and practices. OCC reviews customer complaints and performs transactional testing. Conclusions, including violations of law, Matters Requiring Attention, and other significant recommendations, are documented and communicated to the bank in a Supervisory Letter or Report of Examination.

Q.4.b. To what extent have you determined that servicemembers are victims of unfair or deceptive practices as it regards to student loan benefits?

A.4.b. Examinations conducted in large banks have not identified servicemembers that have been harmed by unfair or deceptive practices related to student loan benefits.

Q.4.c. Are you confident that your supervised institutions are in compliance with the SCRA?

A.4.c. OCC's current supervisory guidance requires annual SCRA examinations. While OCC continues to see improved compliance with SCRA requirements, we will continue to hold banks accountable for compliance with the Act.

Q.4.d. To what extent have you shared these results with the Department of Education and the Department of Justice?

A.4.d. The OCC works closely with the Department of Justice (DOJ) on SCRA matters, including issues that arise in the course of the OCC's examinations of national banks and Federal thrifts and other supervisory activities. As an example, last year the OCC and DOJ engaged in coordinated formal enforcement actions in connection with violations of SCRA by Capital One, N.A., and Capital One Bank (USA), N.A. Less formally, OCC staff also regularly consults with DOJ staff on SCRA questions that arise in connection with the OCC's supervision of national banks and Federal thrifts. For example, the OCC is currently consulting with DOJ regarding the extent to which certain SCRA protections apply to an LLC that is majority owned by a servicemember and his spouse. The OCC believes that these consultations promote more consistent interpretation of SCRA across Government agencies.

The OCC also works with the Department of Education (DOE) regarding student loan issues that have come to the OCC's attention during the course of our supervisory activities. Our opportunities to work with DOE are less frequent than our collaborations with DOJ, in part because the Federal Government now makes Federal student loans directly to students, and national banks and Federal thrifts are not involved with new Federal student loans. Currently, the OCC is consulting with DOE concerning the appropriate way in which servicers of student loans may reconcile an apparent inconsistency between the minimum payment set forth in the Common Manual for servicing Federal student loans and the maximum interest rate provisions of SCRA.

With regard to issues that may arise involving specific student loan transactions or files, the Right to Financial Privacy Act (RFPA), 12 U.S.C. §§ 3401–3422, places statutory limits on the OCC's authority to transfer to other Government agencies the financial records of customers of the financial institutions that the OCC supervises. The OCC must certify that there is reason to believe that the financial records are relevant to a legitimate law enforcement inquiry within the jurisdiction of the Government agency to which it transfers the financial records. 12 U.S.C. § 3412(a). Under the RFPA, it is difficult for the OCC to provide detailed information to the DOE concerning violations of the SCRA, as the DOE has no apparent authority to enforce SCRA against national banks and Federal thrifts.

The RFPA does not limit the transfer of customer financial records to DOJ if the OCC can certify that there is reason to believe that the records may be relevant to a violation of Federal criminal law, and that the OCC obtained the records in the exercise of its supervisory or regulatory functions. 12 U.S.C. § 3412(f)(l)(A) and (B). Thus, because SCRA attaches criminal penalties to the violation of certain provisions of SCRA, the OCC can more easily transfer records to DOJ for possible violations of SCRA.

Q.5.a.–c. The CFPB's May 2013 report, Student Loan Affordability: Analysis of Public Input on Impact and Solutions, raised concerns about the effect of unsustainable levels of student debt. Heavy student loan burdens not only deplete available resources but can also limit the career opportunities of young graduates who must earn salaries that can repay tens or hundreds of thousands of dollars in debt. And, if borrowers fall behind the resulting damage to their credit can further limit access to financing for a home, car, or even daily purchases. Homebuilders and mortgage originators have already noted a decrease in the volume of home purchases by young people, and practitioners in careers that may offer less compensation, including public service and family medicine, have noted that young people are now gravitating toward more lucrative careers to pay back large volumes of debt.

Q.5.a. Has your agency observed differences in home loans, auto loans, and other extensions of credit to young borrowers?

A.5.a. Institutions we regulate do not monitor application or performance statistics based on a borrower's age. While credit card issuers must adhere to specific Regulation Z underwriting requirements for applicants under 21 years of age, credit card portfolios are not typically segmented specifically by age. Some institutions offer "student" credit cards. Age is not a criterion that would determine whether an applicant would be included in the student portfolio and all borrowers classified as students are not necessarily under 21. However, it is likely that the vast majority of student cardholders would be considered "young" borrowers. In institutions where performance of this segment is monitored, performance metrics are not consistent. In some OCC-regulated institutions, younger credit cardholders show better performance metrics than the general population, and, in others, they do not perform as well.

Q.5.b. Given the risks associated with student loans, which are typically underwritten without an extensive borrower credit history, and the relatively more secure, collateralized loans made for homes, cars, and other consumer products, how do you project that the rising burden of student debt will impact the balance sheets of the institutions that you regulate in the long term?

A.5.b. Student lending is a minor segment of most national bank and Federal thrift balance sheets, so the volume of student loan balances is not expected to be a significant concern for the foreseeable future.

Student loan debt service requirements however, may be an issue as debt levels rise. Monthly payments for existing student loans are part of the repayment capacity analyses for all new consumer loans, and rising levels are a claim on monthly cash-flows that may restrict the amount of other debt available to borrowers. Financing an education requires borrowers to manage debt levels and sometimes delay other spending until income levels can handle larger amounts of debt. This may affect growth levels for other products, and lenders will need to remain disciplined and consider total debt burden for all existing debt at each new credit request.

Q.5.c. In your experience, do the private student lenders you regulate extend, or offer to extend, other forms of credit to borrowers of private student loans? How do incentives for customer service and sound financial practices change for private student lenders that do not offer a full suite of financial products?

A.5.c. Most OCC-regulated private student lenders offer a full range of consumer products, including auto loans, credit cards, and mortgages. Many bank customers have student loans and other types of consumer credit. None of the OCC-regulated private student lenders are monoline companies that specialize only in student loans.

Q.6. Your testimony cited OCC guidance issued in 2010 as the standard that regulators use when determining the soundness of bank's decision to work with a troubled borrower. The guidance states that once repayment has begun "private student loans should not be treated differently from other consumer loans except in cases where the borrower returns to school." It further states the loan modifications should be considered for "long-term hardships" and may "temporarily or permanently" reduce interest rates to lower payments but should not include terms that "delay recognition of the problem credit."

How often does each of the private student lenders that you supervise engage in loan modifications for borrowers who are in long-term hardship situations? How often does each of the lenders grant additional forbearance beyond the 6-month introductory period?

A.6. The large OCC-regulated institutions have not generally offered modification programs for long-term hardship situations unless made available as a feature in guaranteed loan portfolios such as The Education Resources Institute, Inc. (TERI). Several institutions will make a modification available to military servicemembers in active duty status. These modifications are decisioned on a case-by-case basis and occur infrequently.

Most large OCC-regulated institutions do grant an additional 6-month forbearance period for borrowers experiencing financial hardship, with appropriate supporting documentation of their hardship.

Q.7. In your testimony, you described that institutions should constructively work with private student loan borrowers to conduct modifications in a safe and sound manner. Given that loan modifications might increase the net present value of certain troubled loans, how does your agency plan to increase the pace of loan modification activity among its supervised institutions?

A.7. The OCC expects lenders to work constructively with troubled borrowers, and to offer prudent loan modification programs when objective analysis indicates the ability to improve cash-flows and performance. As with all consumer products, OCC supervision of student lending loan modification activity generally focuses on the adequacy of information and the quality of decisionmaking. We expect both to be well controlled, structured, and robust, including the development and use of any net present value models used in modification decisions. Where credible net present value evaluations indicate modification and other workout or forbearance actions are prudent, the OCC will continue to encourage institutions to actively engage in the programs.

Q.8. Please provide any interpretive guidance (*e.g.,* for use by examiners, supervised institutions) on the Uniform Retail Classification and Account Management Policy that is specific to private student loans. Describe how your interpretation differs from the guidance used by other prudential regulators.

A.8. In August 2010, the OCC issued CNBE Policy Guidance 2010–02, "Policy Interpretation: OCC Bulletin 2000–20—Application to

Private Student Lending" to examiners to help them interpret the Retail Uniform Classification Policy specifically for private student lending. The guidance explicitly permits national banks and Federal thrifts to engage in the following actions to assist borrowers:

- In-school deferments—allows lenders to postpone a borrower's principal and interest payments as long as the person is enrolled in school at least as a half-time student.
- Grace periods—allows lenders to defer a borrower's payments for 6 months immediately following their departure from school, without conditions or hardship documentation.
- Extended grace periods—allows lenders to defer a borrower's payment for an additional 6 months immediately following the initial grace period for those borrowers who are experiencing a financial hardship. This benefit is available to student loan borrowers who are unemployed or under-employed.
- Short-term forbearance—allows lenders to offer two-to-three month loan extensions to a borrower to address short-term hardships.
- Loan modifications—allows lenders to provide interest rate and payment reductions to borrowers who are experiencing long-term hardships.

Although the OCC was the only prudential regulator to issue specific interpretive guidance for private student lending, in July 2013, the OCC, Federal Deposit Insurance Corporation and the Board of the Governors of the Federal Reserve System issued a joint statement that encourages financial institutions to work constructively with private student borrowers experiencing financial difficulties. The statement reaffirms that the Uniform Classification Policy permits prudent student workout and modifications of retail loans, including private student loans.

Q.9. What is your supervisory approach when conducting examinations of Federal and private student loan servicing activities? What are the risk factors that you look for? Do you have publicly available manuals and guidance that cover student loan servicing? Have you utilized complaints submitted to the CFPB and the Department of Education to scope your exams?

A.9. Many of our large institutions no longer offer private student loans to new borrowers, and are simply servicing existing portfolios. Risks in these portfolios and the focus of OCC supervisory activities are in servicing, collection and recovery activities. Supervision will include reviews of activities performed by the bank's control functions such as internal audit, quality control and quality assurance, particularly when servicing is performed by a third party. Examiners may also include transaction testing to ensure institutions are appropriately offering grace periods, deferments and modifications. In institutions still active in private student loan originations, examiners will also review front-end activities, such as underwriting policies and strategies.

The OCC has no examination manual dedicated specifically to student lending. However, the agency's overall retail credit examination procedures and existing Federal Financial Institutions Examination Council (FFIEC) guidance for retail classification and account management are applicable to student lending. OCC emphasized this in CNBE Policy Guidance 2010–02 and examiners utilize this guidance for private student lending supervisory activities.

Examiners have used complaints filed with the OCC to help guide the scope of examination activities. To date, the Consumer Financial Protection Bureau (CFPB) database or complaints filed with the DOE have not been widely used but all sources of consumer complaints are gaining wider usage during both consumer compliance and safety and soundness supervisory activities.

Q.10. Compared to Direct Loans, it is generally more cumbersome for Federal student loan borrowers to enroll in income-based repayment programs. Many institutions you supervise have significant FFELP holdings. How would you generally assess the ability of your supervised entities to make borrowers aware of and successfully enroll them in income-based repayment options?

A.10. We believe that the institutions we supervise have the ability to make borrowers aware of and successfully enroll in income-based repayment programs. Enrollment criteria and payment terms were established by the Federal Government, and servicers must comply with these terms in approval or payment decisions. Most national bank and thrift servicers provide contact information for troubled borrowers on their Web site and in monthly billing statements. Income-based repayment terms are also widely available on the internet, including on the DOE's Web site.

Q.11.a.–c. In your testimony, you stated that lack of competition in the private student lender market has limited loan refinancing opportunities. But you also stated that pricing of private student loans is based on risk-based pricing and competition within the market.

Q.11.a. Given the lack of competition in this space, how can we assure that low- and middle-income students have access to both affordable loans and loan modification options that reflect the borrower's characteristics and ability and willingness to repay?

A.11.a. Calibrating loan amounts and payment structures to a student borrower's potential future income flows is inherently difficult and the main challenge for both Federal and private loan programs. Most Federal loans are tied more closely to the cost of education and living expenses rather than quantifiable potential future earnings that would limit loan amounts to affordable levels. Federal programs consider this an acceptable risk as they seem more willing to balance potential shortfalls with the general benefits of a broad, highly trained workforce.

Private student lenders tend to have a narrower perspective and are far more concerned with quantifiable sources of repayment at origination. Loan underwriting typically considers affordability and credit performance at inception, and loan amounts and payment terms are set accordingly. Most private student lenders require coborrowers to meet affordability standards and mitigate the lack of a loan guarantee. Modification decisions also tend to be based on available resources from all borrowers, not only the student's income.

The most direct, practical way to assure greater access to affordable loans and primary obligor-based modifications would be to shift more lending for low- and moderate-income students to Federal programs. This would allow greater access to income-based repayment and principal forgiveness programs for low-to-moderate-income borrowers. Simply mandating primary-borrower income-based repayment programs and loan modifications by private student lenders may have the unintended consequence of restricting credit by driving participants out of the market.

Q.11.b. Is there an existing public or private mechanism to encourage more sustainable loan terms and refinancing opportunities for student borrowers?

A.11.b. Most Federal student loan programs offer payment and consolidation options designed to help borrowers manage repayment and debt levels. These include graduated repayment plans, income-contingent repayment plans, extended repayment plans, income-based repayment plans, loan consolidation programs, and loan rehabilitation programs for delinquent borrowers. Most are tied directly to a primary borrower's income and ability to repay and are designed to be sustainable and affordable. Several programs also allow principal forgiveness or administrative forbearance under certain conditions, largely tied to longer-term performance and a primary borrower's income or occupation.

These payment, consolidation, and rehabilitation programs tend to be more expensive than traditional amortizing loan structures used by private student lenders, and encouraging greater use would likely require subsidies or incentives to either adopt similar programs or shift existing loans to Federal programs.

Q.11.c. Without intervention from Congress or regulators, is there reason to believe that private student lenders will actively work with borrowers to issue more sustainable loans and to modify the terms of loans issues prior to the financial crisis to more accurately reflect the risk profile of the borrower given the current lending environment and their financial status?

A.11.c. Private student lenders have inherent financial incentives to work actively with troubled borrowers to maximize cash-flows and minimize losses for existing loans. Even with bankruptcy protection, collections and servicing costs for delinquent student borrowers are expensive, time consuming, and limit profitability. Most private student lenders attempt to control collections expenses by requiring financially responsible coborrowers to mitigate the risk. As a result, initial loan terms and subsequent loan modifications are typically based on available income and resources from all borrowers on the note, not only the primary student.

When modifications and workout programs are used, national banks and Federal thrifts are expected to link decisions directly to the nature of the hardship and the willingness and ability of the borrower(s) to comply with sustainable modification terms. Current lending and economic environments are also a factor, and repayment and modification terms do adjust to consider these factors. For example, high unemployment levels associated with the last recession prompted lenders to offer extended grace periods beyond the initial 6-month period for students having difficulty finding employment.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR MANCHIN FROM JOHN C. LYONS

Q.1. In rural towns across the country, there is a chronic shortage of primary care health professionals. Not just doctors, but nurses and others. According to the American Medical Association, student debt may be a barrier to practicing in underserved communities.

This problem extends beyond health professionals. I hear from West Virginians across my State that the best teachers are retiring and that poorer districts are having a tough time bringing in young people to take their places.

So many rural families want their kids to go to college, but they worry about the impacts of high levels of student loan debt.

In your opinion, how will rural areas survive without critical professions like doctors, nurses, and teachers? What are you doing to make sure that the burden of student debt isn't disproportionately shouldered by rural areas?

A.1. While we do not regulate higher education costs, we recognize the issue and can understand and appreciate the challenges facing rural communities. Situations like this are one of the main reasons Federal student loan programs offer income-based and income-contingent repayment programs that sometimes include principal forgiveness for student loan borrowers who work in underserved areas.

For private student loans, one issue we find extremely important is the need for lenders to tailor workout, forbearance, and modification programs directly to the nature of a borrower's situation. Most often, this includes consideration of co-borrowers, but even so, we expect workout programs and modifications to be objective decisions that lenders offer when a credible analysis indicates that such actions will improve cash-flows. When offered, modification terms should be sustainable, capacity-based, and tied directly to a borrower's current and prospective ability to repay. This will not solve the debt burden issue by itself, but should help ensure that actual income levels are an important consideration whenever modification or workout programs are used.

Q.2.a. It does not make any sense that, under our current system, students are forced to pay high interest rates on Federal student loans when everyone else in the economy benefits from low borrowing costs on everything else. And if we don't act by July 15—every Federal loan will have an interest rate of at least 6.8 percent in 2013, while T-bill rates stay near historic lows.

Not only would moving to a market-based rate allow students to benefit from cheaper borrowing when everyone else can, I expect that private student loan lenders would, in order to remain competitive, lower their rates as well. Under the current system, private lenders know that we have created artificial benchmarks for these rates, so private lenders can always keep their rates unnecessarily high.

How do you believe that implementing a market-based rate for Federal loan programs would affect the private loan market?

A.2.a. We would not expect significant change to the private loan market from implementation of a market-based rate for Federal loans. Private student lenders base pricing on operational costs, funding costs, and the risk in the transaction. Most often today, that includes the structure of the note, repayment capacity of the student, and the financial strength of any available co-borrowers. Other debt, including Federal student loans, is a consideration, but unless the rate change also affects the amount of Federal student loans available, we do not expect a market-based rate for Federal loans would have a substantial influence on lending decisions in the private student loan market.

Q.2.b. Wouldn't allowing Federal rates to fall during times of cheap borrowing—such as today—force private borrowers to lower their interest rates to remain competitive?

A.2.b. Given available subsidies and flexible repayment options under Federal programs, most private student loans today are supplements to Federal programs rather than price-sensitive alternatives. As such, we expect that private student lenders would continue to base loan pricing on the characteristics of the transaction rather than the rate of Federal student programs. The risk in a private student loan today is generally a function of the strength of co-borrowers, a consideration not significantly impacted by Federal rates. We expect Federal program limits and the cost of education to continue to be the main driver of private student loan volumes.

RESPONSE TO WRITTEN QUESTIONS OF CHAIRMAN JOHNSON FROM TODD VERMILYEA

Troubled Debt Restructuring

Q.1. Many lenders have noted that they cannot modify loans because they do not want the modification to be considered a troubled debt restructuring, or TDR, for accounting purposes. Can you describe when a loan modification is a TDR and what role your agency plays in interpreting the accounting standard? Mr. Lyons' testimony stated that "under GAAP a bank must recognize a loan modification for a financially troubled borrower that includes concessions as a TDR, with appropriate loan loss provisions if impairment exists. The designation of a loan as TDR does not prohibit or impede a bank's ability to continue to work with the borrower." Ms. Eberley's testimony noted that "[p]otential or actual treatment as a TDR should not prevent institutions from proactively working with borrowers to restructure loans with reasonable modified terms . . . [t]he FDIC encourages banks to work with troubled borrowers and will not criticize IDI management for engaging in prudent workout arrangements with borrowers who have encountered financial problems, even if the restructured loans result in a TDR designation." Can you describe how designation of loans as TDR factors into an institutions' allowance for loan and lease losses (ALLL), and what role the ALLL plays in calculation of a financial institution's minimum regulatory capital? How would the Basel III rules change the treatment of ALLL in the capital calculation, if at all? Please also describe any other impact designating a loan as TDR has on an institution's balance sheet.

A.1. Under U.S. generally accepted accounting principles (GAAP) and FFIEC Reports of Condition and Income (call reports), a restructuring of a debt constitutes a troubled debt restructuring (TDR) if the creditor for economic or legal reasons related to the debtor's financial difficulties grants a concession to the debtor that it would not otherwise consider. The determination of whether a restructured loan is a TDR requires judgment and consideration of all of the facts and circumstances surrounding the modification. Accordingly, examiners reviewing an institution's accounting for modification must use judgment when assessing whether the criteria for a TDR have been met.

Under U.S. GAAP, any loan modified in a TDR is an impaired loan. Financial Accounting Standards Board Accounting Standards Codification 310, Receivables, states that impaired loans should be measured for impairment using (1) the present value of expected future cash-flows discounted at the loan's effective interest rate, (2) the loan's observable market price, or (3) the fair value of the collateral if the loan is collateral dependent. An institution may choose the appropriate ASC 130 measurement method on a loan-by-loan basis for an individually impaired loan to be measured using the fair value of collateral method. Generally, an allowance for loan losses is established for the amount of the impairment.

There are several regulatory capital ratios. Regulatory capital ratios are generally calculated by dividing capital (calculated in a defined way) by assets (calculated in a defined way). GAAP capital is the basis for the numerator. When an allowance is established, earnings, and therefore GAAP capital, is reduced. For one of the capital ratios (Total Capital), the ALLL is added back to capital up to 1.25 percent of the bank's gross risk-weighted assets. For each of the ratios, risk-weighted assets are reduced by the amount of ALLL in excess of 1.25 percent of the bank's gross risk-weighted assets.

Finally, regarding the impact of Basel III, there should be no impact since Basel III did not include specific changes to the treatment of ALLL. Designation of a loan as TDR has no other impact on an institution's balance sheet.

Guidance

Q.2. Mr. Lyons stated in his testimony that the OCC issued supplemental guidance to its examiners in 2010 interpreting the Uniform Retail Classification and Account Management Policy (Retail Policy) in the context of private student lending. However, that guidance is not available to private student lenders, borrowers, or any other market participants. Does the OCC plan to make this guidance public or otherwise provide information to the institutions that it regulates on supervisory expectations for managing forbearance, workout, and modification programs? Mr. Vermilyea stated in his testimony that the Retail Policy is "timeless." The Retail Policy was revised in 2000, which superseded a 1999 revision, which in turn revised a policy from 1980. The private student loan market quadrupled from 2001 to 2008 and just as rapidly declined through 2012. Given the marked changes in the student loan market since publication of the Retail Policy in 2000, what criteria do the agencies, either individually or through the Federal Financial Institutions Examination Council, use to determine when it is appropriate to revisit retail credit policy? When would it be appropriate to provide guidance to private student lenders regarding supervisory minimum expectations?

A.2. The Retail Policy is quite broad and it covers not just student loans, but most other types of closed-end and open-end retail credit extensions. As such, it applies generally to retail portfolios and embodies sound risk management principles that are timeless and still very much applicable. While the student loan market has indeed grown in size in the mid-2000s, the underlying risk management principles applicable to it have remained the same.

To remind both examiners and banks of the important risk management principles in the Retail Policy, and of the appropriateness of prudent loan modifications, on July 25, the three banking regulatory agencies issued a joint statement, which encourages regulated institutions to work with student loan borrowers based on the prudent principles of the Retail Policy.[1]

The Federal Reserve has no set timetable or policy to determine when it is appropriate to revisit policies. Every policy is a separate case and whether or not it needs to be updated or refreshed is evaluated on its own merits.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR CRAPO FROM TODD VERMILYEA

Q.1. The OCC published updated retail credit classification guidance on private student loans in 2010. The FDIC testified at the hearing that it would release updated guidance in the near future.

Does the Federal Reserve have any plans to publish updated retail credit classification guidance specific to private student loans?

A.1. The Retail Credit Classification Policy embodies sound risk management principles that are timeless and remain very much applicable to today's market conditions; no plan exists currently to update it. However, to remind both examiners and banks of those important risk management principles and of the appropriateness of prudent loan modifications, on July 25, the three banking regulatory agencies issued a joint statement, which encourages regulated institutions to work with student loan borrowers based on the prudent principles of the Retail Policy.[1]

Q.2. Does the Federal Reserve view private student loans as a unique type of retail consumer credit?

A.2. The student loan market is unique in that it is comprised of long-term unsecured debt where, the source of expected repayment is contingent on the future productivity of the borrower. The Federal Reserve is cognizant of the important social implications of private student loans. Student loan borrowers who are unemployed or underemployed may not have sufficient financial capacity to service their private student loan debts shortly after separation from school or during periods of economic difficulty.

As with other consumer lending activities, the Federal Reserve encourages financial institutions to consider prudent workout arrangements that increase the potential for financially stressed bor-

[1] *http://www.Federalreserve.gov/newsevents/press/bcreg/20130725a.htm.*

[1] *http://www. Federalreserve.gov/newsevents/press/bcreg/20130725a.htm.*

rowers to repay private student loans whenever workout arrangements are economically feasible and appropriate.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR BROWN FROM TODD VERMILYEA

Q.1.a.–b. In the years leading up to the financial crisis, the Student Loan Asset Backed Securities (SLABS) market experienced unprecedented growth. SLABS issuance grew to more than $16 billion annually to feed investor demand for these securities. To increase volume, higher dollar value loans were made to a greater range of borrowers before being securitized. Multiple witnesses noted that the loans still held in securitized trusts may have fewer modification and refinance opportunities than those retained on a bank's balance sheet, further limiting options for borrowers and raising the risk of default.

Q.1.a. Where applicable, what percentage of student loans originated by institutions regulated by your agency and still in repayment is held in securitized trusts? What percentage is held on banks' balance sheets?

A.1.a. The Federal Reserve is the primary supervisory authority of one institution that originates student loans: SunTrust Bank, a State member bank SunTrust issued one student loan asset-backed security in 2006, which was for $765 million worth of Federal Family Education Loans (FFELP), or Government-guaranteed, loans as opposed to private student loans, which was the focus of the hearing. Using the current securitized balance of $360 million, and total student loan balance of $5.942 billion, the percentage of SunTrust's loans held in securitized trusts is 6.06 percent, and the remainder, 93.94 percent, is held on the balance sheet.

Q.1.b. Is there a difference in the performance of loans that have been securitized and those that are held directly on a bank's balance sheet?

A.1.b. According to data from the Consumer Financial Protection Bureau (CFPB) and ratings agency DBRS, industry cumulative default rates for private student loan vintages reveal that the performance of loans that have been securitized is poorer than the overall student loan market.

Vintage	Overall Student Loan Market	Securitized Private Student Loan Market
2005	10.5%	17.9%
2006	9.0%	15.5%
2007	7.0%	17.9%

In his testimony, Mr. Chopra stated that mortgage and student loan borrowers may have more difficulties working out a modification or forbearance when those loans have been securitized, but fewer barriers exist for student loan borrowers than existed in the mortgage market.

Q.1.c. What additional barriers to forbearance and modifications exist for private student loan borrowers whose loans were securitized?

A.1.c. When it comes to working with a troubled borrower, it does not matter whether the loan has been securitized or not. Private student loans, as a credit risk for the bank, may face different forbearance or modification options than Government-guaranteed student loans. On July 25, the three banking regulatory agencies issued a joint statement encouraging regulated institutions to work with student loan borrowers based on the prudent principles of the Retail Policy.[1]

Q.1.d. How are contract conditions for SLABS different from conditions for mortgage-backed securities?

A.1.d. The differences between student loan asset-backed securities and mortgage-backed securities has more to do with the origination and nature of the loan.

At mortgage origination, the securitizing institution typically requires extensive financial data before making the loan. This information is required if the institution chooses to sell the loan to a Government-sponsored entity (GSE) such as Fannie Mae or Freddie Mac. For mortgages, the banks self-police to verify that they have followed the associated agency's guidelines. Issues with the self-policing allowed the GSEs to retroactively find fault in the loan documentation and force the originating bank to repurchase the mortgage.

For Government-guaranteed student loans, typically a private institution issues the loan on behalf of a State agency that has the backing of the Federal Government. For these loans, the State agency that guarantees the loan reviews the application before making the guarantee and before the bank disperses the funds to the school. The independence of the FFELP guarantor from the holder in due course lender is a critical distinction when compared to the mortgage origination process. As FFELP loans are certified and guaranteed during the origination process, the guarantor cannot later find fault and dishonor its own guarantee. As such, the FFELP student loan market will avoid the repurchase risk that the mortgage market experienced.

Q.1.e. What would be required to offer borrowers with securitized loans the same options that can be afforded to borrowers whose loans were not securitized?

A.1.e. When it comes to forbearing or modifying a private student loan, it does not matter whether the loan has been securitized or not, and therefore nothing would be required to offer borrowers with securitized loans the same options that can be afforded to borrowers whose loans were not securitized. Regardless of whether a student loan has been securitized or not, if it is an FFELP loan, modification and forbearance guidelines as provided by the Department of Education must be followed.

Q.2. As a voting member agency of the Financial Stability Oversight Council, I am interested in your views on how you assess

[1] See *http://www.Federalreserve.gov/newsevents/press/bcreg/20130725a.htm.*

whether an entity would meet the criteria to be designated a systemically important financial institutions (SIFI). Specifically, given its extremely large footprint in servicing Direct, FFELP, and private student loans, what would be the broader impact on consumers and markets if SLM Corp. (Sallie Mae) were to fail?

A.2. The designation of systemically important financial institutions (SIFI) is a matter that only the Financial Stability Oversight Council (FSOC) can determine. To date, FSOC has designated two nonbank financial companies as SIFIs, AIG, Inc. and GE Capital Corporation, in addition to eight financial market utility firms. The Federal Reserve does not have regulatory authority over the SLM Corp. and has not conducted an assessment of the firm.

Q.3.a.–d. In October 2012, the Consumer Financial Protection Bureau issued a report about problems servicemembers face when utilizing benefits guaranteed by Federal law, even on Government-guaranteed student loans. Your agency supervises institutions with FFELP portfolios.

Q.3.a. Have you focused on these portfolios in your examinations?

A.3.a. Please see response to question 3, part d.

Q.3.b. To what extent have you determined that servicemembers are victims of unfair or deceptive practices as it regards to student loan benefits?

A.3.b. Please see response to question 3, part d.

Q.3.c. Are you confident that your supervised institutions are in compliance with the SCRA?

A.3.c. Please see response to question 3, part d.

Q.3.d. To what extent have you shared these results with the Department of Education and the Department of Justice?

A.3.d. The Federal Reserve supports the CFPB's efforts to highlight options that may be available to servicemembers pursuant to student loan programs. Although we do not supervise the administration of student loan programs, as a bank supervisor, we do encourage supervised banks to work with student borrowers. On July 25, the Federal Reserve Board joined other Federal bank regulatory agencies in issuing a statement encouraging financial institutions to work constructively with private student loan borrowers experiencing financial difficulties. Prudent workout arrangements are consistent with safe and sound lending practices and are generally in the long-term best interest of both the financial institution and the consumer.

The Federal Reserve also supports the objectives of the Servicemembers Civil Relief Act (SCRA). Through our supervisory role, we evaluate whether the financial institutions we supervise are complying with the SCRA and the unfair and deceptive acts and practices provisions of the Federal Trade Commission Act (FTC Act). Examinations are conducted on a regular schedule by specially trained consumer compliance examiners. As a standard practice, SCRA compliance is evaluated as part of these scheduled consumer compliance examinations using detailed SCRA examination procedures.

As part of their review of an institution's SCRA policies, procedures, and practices, examiners evaluate any consumer complaints received by the Federal Reserve through the consumer complaint program, or by the institution itself, regarding SCRA to better scope their examinations, and identify risks and potential problem areas. Any instances of noncompliance with the consumer protection laws and regulations, including SCRA and the FTC Act—regardless of whether the product is a mortgage or student loan—are reported to the management of the financial institution and corrective action is required. At this time, we have not identified any violations of the FTC Act's unfair and deceptive provisions or any violations of the SCRA in connection with servicemember student loans.

Finally, we engage in periodic discussions with other agencies and engage in industry outreach. In the fall of 2013, we sponsored a free Outlook Live Webinar on Servicemember Financial Protection that included SCRA. Several agencies, including the CFPB and the Department of Justice, participated; the Webinar attracted over 4,000 registrants.

Q.4.a.–c. The CFPB's May 2013 report, Student Loan Affordability: Analysis of Public Input on Impact and Solutions, raised concerns about the effect of unsustainable levels of student debt. Heavy student loan burdens not only deplete available resources but can also limit the career opportunities of young graduates who must earn salaries that can repay tens or hundreds of thousands of dollars in debt. And, if borrowers fall behind the resulting damage to their credit can further limit access to financing for a home, car, or even daily purchases. Homebuilders and mortgage originators have already noted a decrease in the volume of home purchases by young people, and practitioners in careers that may offer less compensation, including public service and family medicine, have noted that young people are now gravitating toward more lucrative careers to pay back large volumes of debt.

Q.4.a. Has your agency observed differences in home loans, auto loans, and other extensions of credit to young borrowers?

A.4.a. Please see response to question 4, part c.

Q.4.b. Given the risks associated with student loans, which are typically underwritten without an extensive borrower credit history, and the relatively more secure, collateralized loans made for homes, cars, and other consumer products, how do you project that the rising burden of student debt will impact the balance sheets of the institutions that you regulate in the long term?

A.4.b. Please see response to question 4, part c.

Q.4.c. In your experience, do the private student lenders you regulate extend, or offer to extend, other forms of credit to borrowers of private student loans? How do incentives for customer service and sound financial practices change for private student lenders that do not offer a full suite of financial products?

A.4.c. Following the financial crisis, most institutions have tightened underwriting standards for all loans. To date, the Federal Reserve has not observed a defined pattern where student-loan indebtedness has limited demand for other consumer loan products.

However, we are monitoring student loan debt levels because we have concerns. First, a larger student loan balance increases debt payment burdens and reduces disposable income, which in turn reduces a consumer's demand for other consumer debt. Second, high student loan payments and potential delinquencies on such loans may make it harder for borrowers to obtain additional consumer loans.

However, it is important to note that the incomes of young households with education debt tend to be higher than the incomes of those without education debt due to the positive returns to college education. Consequently, to the extent that higher income can be associated with greater demand for other consumer loan products, there is likely little impact on the extension of other forms of consumer credit.

According to the CFPB, of the $1 trillion in total outstanding student debt, $150 billion consists of private student loans, and includes loans made not only by banks but by credit unions, State agencies, and schools themselves. While Federal student loan originations have continued to increase each year, private loan originations peaked in 2008 at roughly $25 billion and have since dropped sharply to just over $8 billion. To date, the delinquency among private student loans is roughly 5 percent, according to the CFPB, less than half of the delinquency rate for all outstanding student loans. There are likely a number of factors underlying the difference between the performance of the Government-guaranteed and private student loan portfolios. For instance, underwriting standards in the private student loan market have tightened considerably since the financial crisis. Almost 90 percent of these loans now require a guarantor or cosigner.

In the case of SunTrust, the only private student loan lender where the Federal Reserve acts as the primary regulatory authority, that institution offers a full range of consumer products in addition to private student loans.

Q.5. Your testimony cited OCC guidance issued in 2010 as the standard that regulators use when determining the soundness of bank's decision to work with a troubled borrower. The guidance states that once repayment has begun "private student loans should not be treated differently from other consumer loans except in cases where the borrower returns to school." It further states the loan modifications should be considered for "long-term hardships" and may "temporarily or permanently" reduce interest rates to lower payments but should not include terms that "delay recognition of the problem credit."

How often does each of the private student lenders that you supervise engage in loan modifications for borrowers who are in long-term hardship situations? How often does each of the lenders grant additional forbearance beyond the 6-month introductory period?

A.5. The Federal Reserve does not have comprehensive data on the frequency in which regulated institutions engage in loan modifications. However, the Federal Reserve encourages its regulated institutions to work constructively with borrowers who have a legitimate hardship. The aim of such work should be the development of sustainable repayment plans while also preserving the safety and soundness of the lending institution and maintaining compliance with supervisory guidance and accounting regulations.

Q.6. In your testimony, you described that institutions should constructively work with private student loan borrowers to conduct modifications in a safe and sound manner. Given that loan modifications might increase the net present value of certain troubled loans, how does your agency plan to increase the pace of loan modification activity among its supervised institutions?

A.6. On July 25, the Federal Reserve Board joined other Federal bank regulatory agencies in issuing a statement encouraging financial institutions to work constructively with private student loan borrowers experiencing financial difficulties. Prudent workout arrangements are consistent with safe and sound lending practices and are generally in the long-term best interest of both the financial institution and the consumer. Moreover, Federal Reserve examiners will not criticize institutions that engage in prudent loan modifications, but rather will view such modifications as a positive action when they mitigate credit risk.

Q.7. Please provide any interpretive guidance (*e.g.,* for use my examiners, supervised institutions) on the Uniform Retail Classification and Account Management Policy that is specific to private student loans. Describe how your interpretation differs from the guidance used by other prudential regulators.

A.7. No interpretative guidance is applicable to the Uniform Retail Classification and Account Management Policy, as this policy is fairly detailed, clear, and self-explanatory. Nevertheless, to remind both examiners and banks of the important risk management principles contained in the policy and of the appropriateness of prudent loan modifications, on July 25, the three banking regulatory agencies issued a joint statement, which encourages borrowers to work with student loan borrowers based on the prudent principles of the Retail Policy.

Q.8. What is your supervisory approach when conducting examinations of Federal and private student loan servicing activities? What are the risk factors that you look for? Do you have publicly available manuals and guidance that cover student loan servicing? Have you utilized complaints submitted to the CFPB and the Department of Education to scope your exams?

A.8. The Federal Reserve's supervision of institutions engaged in the student loan market is similar to our supervision of other retail credit markets and products. For the largest institutions that the Federal Reserve regulates with significant student loan portfolios, we have onsite examination staff that evaluate the institution's risk-management practices, including adherence to sound underwriting standards, timely recognition of loan deterioration, and appropriate loan provisioning.

The regulations that the Federal Reserve utilizes to examine institutions are published on our Web site. The Department of Education has a common servicing standards manual for all student loan servicers.

As part of any examination of an institution, Federal Reserve examiners would look at any consumer complaints received by the

Federal Reserve through our consumer complaint program, or by the institution itself, to better scope the examination and identify potential risks.

Q.9. Compared to Direct Loans, it is generally more cumbersome for Federal student loan borrowers to enroll in income-based repayment programs. Many institutions you supervise have significant FFELP holdings. How would you generally assess the ability of your supervised entities to make borrowers aware of and successfully enroll them in income-based repayment options?

A.9. As referenced above, in July 2013, the Federal Reserve joined other Federal bank regulatory agencies in issuing a statement encouraging financial institutions to work constructively with private student loan borrowers experiencing financial difficulties. In part, this guidance directs supervised institutions "that have student loan modification programs, or other options for those struggling with repayment, should provide borrowers with practical information that explains the basic options available, general eligibility criteria, and the process for requesting a modification."

Federal Reserve examiners will monitor effective implementation of this guidance at the one State member bank that offers FFLEP loans.

Q.10.a.–b. Your testimony focused heavily on forbearance as a method of relief for private student loan borrowers. But the volume and terms of private student loans issued in the years leading up to the financial crisis indicate that many of these loans may not be sustainable even after forbearance periods. The Consumer Financial Protection Bureau's July 2012 report documented a 400 percent increase in the volume of private student loan debt originated between 2001 and 2008, and 2008 originations surpassed $20 billion. The report also shows that, from 2005 to 2008, undergraduate and graduate borrowers of private student loans took on debt that exceeded their estimated tuition and fees, and in some years more than 30 percent of loans were made directly to students with no certification of enrollment from their academic institution. The heavy debt burden that was created in these few years is not just unsustainable by dollar volume, but also in loan terms. Loans were often variable rate loans with initial interest rates ranging from 3 percent to more than 16 percent.

Q.10.a. Given these extremely unfavorable loan terms that were made to a larger number of borrowers, presumably including more students from limited financial means, do loans originated between 2001 and 2008 comply with your standards for safety and soundness?

A.10.a. Please see response for question 10, part b.

Q.10.b. How would refinancing the highest-cost loans to reflect borrowers' current characteristics affect the soundness of a regulated institution's balance sheet in the short and long term?

A.10.b. The Federal Reserve takes a horizontal view of the student loan market across multiple firms during the Comprehensive Capital Analysis and Review (CCAR) exercise, an important supervisory tool that the Federal Reserve deploys, in part, to enhance financial stability by assessing all exposures on bank balance sheets.

CCAR was established to ensure that each of the largest U.S. bank holding companies: (1) has rigorous, forward-looking capital planning processes that effectively account for the unique risks of the firm; and (2) maintains sufficient capital to continue operations throughout times of economic and financial stress. The CCAR exercise collects data on banks' student loan portfolios, delineated by loan type (Federal or private), age, FICO Score, delinquency status, and loan purpose (graduate or undergraduate).

The banks submitting student loan data for CCAR held just over $63 billion in both Government-guaranteed and private student loans at year-end 2012, of which $23.6 billion represented outstanding private student loans. At the end of 2012, CCAR banks reported that just over 4 percent of private student loan balances were in delinquency, but more than 21 percent of Government-guaranteed student loan balances were delinquent. Nevertheless, the delinquency rate for Government-guaranteed student loans has shown improvement over recent quarters, dropping from a high of more than 23 percent. Likewise, the delinquency rate for private loans at CCAR firms trended upward through mid-2009 but has since moved down, which is comparable to the performance of the overall private student loan market.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR MANCHIN FROM TODD VERMILYEA

Q.1. In rural towns across the country, there is a chronic shortage of primary care health professionals. Not just doctors, but nurses and others. According to the American Medical Association, student debt may be a barrier to practicing in underserved communities.

This problem extends beyond health professionals. I hear from West Virginians across my State that the best teachers are retiring and that poorer districts are having a tough time bringing in young people to take their places.

So many rural families want their kids to go to college, but they worry about the impacts of high levels of student loan debt?

In your opinion, how will rural areas survive without critical professions like doctors, nurses, and teachers? What are you doing to make sure that the burden of student debt isn't disproportionately shouldered by rural areas?

A.1. Education is one of the impost important drivers of social mobility. On average, attending college appears to be beneficial from a financial standpoint if a degree is obtained and employment is found. Numerous studies, including several undertaken recently, have found that the average wage premiums earned by college graduates remain substantial, and, in this particular sense, attending college appears to be a very good investment. In addition, unemployment rates for college graduates are lower than for high school graduates. A recent research paper prepared by the Federal Reserve Bank of Kansas City noted that the "preponderance of research suggests" that the value of a college education outweighs the costs. *https://www.kansascityfed.org/publicat/reswkpap/pdf/rwp%2012-05.pdf.*

That is again why, on July 25, the Federal Reserve Board joined other Federal bank regulatory agencies in issuing a statement encouraging financial institutions to work constructively with private student loan borrowers experiencing financial difficulties. Prudent workout arrangements are consistent with safe and sound lending practices and are generally in the long-term best interest of both the financial institution and the consumer.

Q.2. It does not make any sense that, under our current system, students are forced to pay high interest rates on Federal student loans when everyone else in the economy benefits from low borrowing costs on everything else. And if we don't act by July 1st, every Federal loan will have an interest rate of at least 6.8 percent in 2013, while T-bill rates stay near historic lows.

Not only would moving to a market-based rate allow students to benefit from cheaper borrowing when everyone else can, I expect that private student loan lenders would, in order to remain competitive, lower their rates as well. Under the current system, private lenders know that we have created artificial benchmarks for these rates, so private lenders can always keep their rates unnecessarily high.

How do you believe that implementing a market-based rate for Federal loan programs would affect the private loan market? Wouldn't allowing Federal rates to fall during times of cheap borrowing—such as today—force private borrowers to lower their interest rates to remain competitive?

A.2. The Federal Reserve does not have statutory supervisory power or a policymaking mandate over Federal student loan programs. The Department of Education is responsible for administering the various Federal student loan programs. The Federal Reserve would ensure that the institutions we regulate remain in compliance with all statutory requirements associated with student loan programs.

RESPONSE TO WRITTEN QUESTIONS OF CHAIRMAN JOHNSON FROM DOREEN R. EBERLEY

Troubled Debt Restructuring

Q.1. Many lenders have noted that they cannot modify loans because they do not want the modification to be considered a troubled debt restructuring, or TDR, for accounting purposes. Can you describe when a loan modification is a TDR and what role your agency plays in interpreting the accounting standard? Mr. Lyons' testimony stated that "under GAAP a bank must recognize a loan modification for a financially troubled borrower that includes concessions as a TDR, with appropriate loan loss provisions if impairment exists. The designation of a loan as TDR does not prohibit or impede a bank's ability to continue to work with the borrower." Ms. Eberley's testimony noted that "[p]otential or actual treatment as a TDR should not prevent institutions from proactively working with borrowers to restructure loans with reasonable modified terms . . . [t]he FDIC encourages banks to work with troubled borrowers and will not criticize IDI management for engaging in prudent workout arrangements with borrowers who have encountered financial problems, even if the restructured loans result in a TDR designation." Can you describe how designation of loans as TDR factors into an institutions' allowance for loan and lease losses (ALLL), and what role the ALLL plays in calculation of a financial institution's minimum regulatory capital? How would the Basel III rules change the treatment of ALLL in the capital calculation, if at all? Please also describe any other impact designating a loan as TDR has on an institution's balance sheet.

A.1. U.S. generally accepted accounting principles (GAAP) state that a restructuring or modification of a debt constitutes a troubled debt restructuring (TDR) if the creditor, for economic or legal reasons related to the debtor's financial difficulties, grants a concession to the debtor that the creditor would not otherwise consider were it not for the debtor's financial difficulties.[1] When the terms of a loan are modified, an institution must apply judgment and consider all relevant facts and circumstances when determining (1) whether the debtor is experiencing financial difficulties and (2) whether the institution has granted a concession. The relevant accounting principles also include guidance on making these determinations.[2]

With regard to the FDIC's role in interpreting accounting standards, pursuant to Section 37 of the Federal Deposit Insurance Act, the accounting principles applicable to the regulatory reports insured banks and savings associations file with the Federal banking agencies—the Consolidated Reports of Condition and Income (Call Report)—must be "uniform and consistent with" GAAP. The Call Report instructions issued by the Federal Financial Institutions Examination Council (FFIEC), of which the FDIC is a member, summarize GAAP for TDRs. These instructions and other supervisory and reporting materials issued by the FDIC, including through the FFIEC, also provide additional interpretational and application guidance on accounting and reporting for TDRs that is intended to be consistent with GAAP. Examples include the interagency Policy Statement on Prudent Commercial Real Estate Loan Workouts and the FDIC's Supervisory Insights article Accounting for Troubled Debt Restructurings. These and other additional guidance have been developed in response to questions from bankers and examiners and are intended to promote consistency in the accounting and reporting of TDRs.

Under GAAP, a loan restructured as a TDR is an impaired loan. All impaired loans, including TDRs, must be measured for impairment in accordance with accounting principles.[3] The principles sets forth measurement methods for estimating the portion of an institution's overall ALLL attributable to impaired loans, including those that are TDRs and those that are not. Many loans whose terms are modified in TDRs will already have been identified as impaired loans before they are restructured. In these situations, because the allowances for these individually impaired loans would be measured under accounting principles both before and after they have been modified, their allowances likely would not materially change as a result of the restructurings. The remainder of an institution's overall ALLL would be determined in accordance with ad-

[1] See Accounting Standards Codification Subtopic 310–40, Receivables—Troubled Debt Restructurings by Creditors.
[2] Ibid.
[3] ASC Subtopic 310–10, Receivables—Overall.

ditional accounting principles as appropriate.[4] For regulatory reporting purposes, an institution also would be expected to follow the relevant Call Report instructions and supervisory guidance when determining the appropriate level for its overall ALLL. In addition, according to accounting principles,[5] a credit loss on a loan, including a TDR, which maybe for all or part of the loan, should be deducted from the ALLL and the related loan balance should be charged off in the period when the loan is deemed uncollectible.

For regulatory capital purposes, an institution's ALLL generally is included in tier 2 capital up to a maximum of 1.25 percent of gross risk-weighted assets. Gross risk-weighted assets are reduced by the amount of any excess over the 1.25 percent limit when determining total risk-weighted assets. However, for an advanced approaches institution under the Basel II capital rules (in general, an institution with $250 billion or more in consolidated total assets or $10 billion or more in consolidated total on balance sheet foreign exposure as well as a subsidiary of such an institution) after its parallel run period, the treatment of the ALLL for purposes of measuring regulatory capital depends on its level in relation to expected credit losses, as defined in the rule. If the ALLL and other "eligible credit reserves" are less than an institution's total expected credit losses, in general, 50 percent of the shortfall is deducted from tier 1 capital and 50 percent of the shortfall is deducted from tier 2 capital. If the ALLL and other "eligible credit reserves" are greater than an institution's total expected credit losses, the institution may include the excess amount in tier 2 capital up to a maximum of 0.6 percent of risk-weighted assets.

The Basel III rules do not change the percentage limit on the amount of an institution's ALLL that can be included in tier 2 capital. However, the measurement of risk-weighted assets was revised under Basel III. As a result, the application of the 1.25 percent of total risk-weighted assets limit on the amount of an institution's ALLL eligible for inclusion in tier 2 capital would cause the institution's eligible ALLL under Basel III to be different than under the current regulatory capital risk-weighting rules. For an advanced approaches institution that has completed the parallel run process and has been approved to apply these approaches, the Basel III rules require the entire amount by which the ALLL and other "eligible credit reserves" are less than an institution's total expected credit losses to be deducted from common equity tier 1 capital.

Guidance

Q.2. Mr. Lyons stated in his testimony that the OCC issued supplemental guidance to its examiners in 2010 interpreting the Uniform Retail Classification and Account Management Policy (Retail Policy) in the context of private student lending. However, that guidance is not available to private student lenders, borrowers, or any other market participants. Does the OCC plan to make this guidance public or otherwise provide information to the institutions that it regulates on supervisory expectations for managing forbear-

[4] ASC Subtopic 450–20, Contingencies—Loss Contingencies, and ASC Subtopic 310–30, Receivables—Loans and Debt Securities Acquired with Deteriorated Credit Quality.

[5] ASC Subtopic 310–10.

ance, workout, and modification programs? Mr. Vermilyea stated in his testimony that the Retail Policy is "timeless." The Retail Policy was revised in 2000, which superseded a 1999 revision, which in turn revised a policy from 1980. The private student loan market quadrupled from 2001 to 2008 and just as rapidly declined through 2012. Given the marked changes in the student loan market since publication of the Retail Policy in 2000, what criteria do the agencies, either individually or through the Federal Financial Institutions Examination Council, use to determine when it is appropriate to revisit retail credit policy? When would it be appropriate to provide guidance to private student lenders regarding supervisory minimum expectations?

A.2. The FDIC supervises private student loan (PSL) lenders using the same framework of safety and soundness and consumer protection rules, policies, and guidance as for other consumer loans. The interagency Uniform Retail Credit Classification and Account Management Policy (Retail Credit Policy) applies to student loans as it does to other unsecured personal loans. The Retail Credit Policy provides principles-based guidance to insured depository institutions on classifying retail credits for regulatory purposes and establishing policies for working with borrowers experiencing financial problems.

Some confusion has recently been expressed in the industry regarding regulatory policies for providing flexibility for institutions to modify or restructure PSLs. In response, the FDIC, jointly with the FRB and OCC, issued a statement on July 25, 2013, to their respective supervised institutions to clarify and reiterate that the interagency Retail Credit Policy applies to PSLs, allows broad flexibilities to institutions specifically related to working with PSL borrowers experiencing financial difficulties, and permits workouts, deferrals, and renewals to help borrowers overcome temporary financial difficulties. The statement emphasizes that our supervised institutions should be transparent and make sure that borrowers are aware of the availability of workout programs.

RESPONSE TO WRITTEN QUESTION OF SENATOR CRAPO FROM DOREEN R. EBERLEY

Q.1. The FDIC testified that it would provide guidance on private student loans in the near future.

- What factors contributed to the FDIC's decision to publish new guidance specific to private student loans?
- Did the FDIC consult any other prudential banking regulator or the CFPB in developing the expected guidance?

A.1. The FDIC considered information, including recent Consumer Financial Protection Bureau (CFPB) reports regarding student loans, and consulted with other Federal banking agencies about the Retail Credit Policy. The FDIC, jointly with other Federal bank regulators (FRB and OCC), recently issued a statement applicable to the banks each agency supervises to reiterate and specifically clarify that the current regulatory guidance provides institutions with broad flexibilities to help student loan borrowers overcome temporary financial difficulties, including through prudent extensions, deferrals, and rewrites. We also informed the CFPB that we would be issuing such a statement.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR BROWN FROM DOREEN R. EBERLEY

Q.1.a.–b. In the years leading up to the financial crisis, the Student Loan Asset Backed Securities (SLABS) market experienced unprecedented growth. SLABS issuance grew to more than $16 billion annually to feed investor demand for these securities. To increase volume, higher dollar value loans were made to a greater range of borrowers before being securitized. Multiple witnesses noted that the loans still held in securitized trusts may have fewer modification and other refinance opportunities than those retained on a bank's balance sheet, further limiting options for borrowers and raising the risk of default.

Q.1.a. Where applicable, what percentage of student loans originated by institutions regulated by your agency and still in repayment is held in securitized trusts? What percentage is held on banks' balance sheets?

A.1.a. About 25 percent of the estimated $150 billion in private student loans (PSLs) outstanding are in securitization trusts; most of the remainder are on banks' balance sheets, although some State-sponsored agencies and other organizations securitize or hold small amounts of PSLs.

Q.1.b. Is there a difference in the performance of loans that have been securitized and those that are held directly on a bank's balance sheet?

A.1.b. As noted in Ms. Eberley's testimony, specific data on PSLs are not reported separately on the Call Reports, which banks file quarterly. Student loans are a fairly small portion of aggregate consumer lending and relatively few banks make these types of loans. Data on PSLs, like other unsecured installment loans, are reported under the broader loan category "other loans to individuals." The PSL lenders supervised by the FDIC reported past due rates (30 or more days delinquent) just under 3 percent of total student loan balances and annual charge-offs just over 1.5 percent at the upper end of the range.

In June of this year, Moody's Investors Service reported that the average default rate for securitized private loans (equivalent to the regulatory charge-off rate) fell from 5.0 percent during first quarter 2012 to 4.0 percent during first quarter 2013. Despite this improvement, the default rate is still about 50 percent higher than it was prior to the recession. Moody's also reported that the 90-day and over delinquency rate dropped slightly from 2.5 percent in first quarter 2012 to 2.4 percent during first quarter 2013.

Q.1.c. In his testimony, Mr. Chopra stated that mortgage and student loan borrowers may have more difficulties working out a modification or forbearance when those loans have been securitized, but fewer barriers exist for student loan borrowers than existed in the mortgage market.

- What additional barriers to forbearance and modifications exist for private student loan borrowers whose loans were securitized?
- How are contract conditions for SLABS different from conditions for mortgage-backed securities?

A.1.c. As discussed in Ms. Eberley's testimony, for securitized loan pools, payment restructuring and modification options maybe limited by the terms of the securitization governing documents. As a result, when repayment difficulties arise, the borrower will be dealing with the servicer, not the original lender. Although student loan borrowers whose loans were securitized may face barriers to forbearance and modification, the barriers could be less onerous and less explicit than those that existed with the private-label mortgage-backed securities originated in the period leading up to the financial crisis.

The type of loan and nature of the servicing arrangement appear to more directly impact modification and forbearance options for distressed student loan borrowers. Federal student loan (FSL) servicing standards are uniform and modifications are statutorily based and, therefore, available regardless of whether they are securitized. The standards for PSL servicing vary by servicer, as do options for modification. FSLs typically offer more forbearance and modification options than PSLs.

Generally, the governing securitization documents for PSLs do not explicitly limit modifications to loans underlying securitizations, but the structure of the securitization may influence how servicers apply forbearance and modification. For example, the interest payments that are received from the underlying loans that are over and above the interest payments to bondholders are considered "excess spread," which is a form of overcollateralization for the securitization that provides protections to bondholders. Servicers maybe less willing to provide modifications if doing so would extract more cash-flow from the underlying loans to maintain excess spread. Another common structural feature that the PSL asset-backed securities and private-label mortgage-backed securities share is a senior/subordinate structure, where cash-flows are diverted to senior bondholders when certain performance triggers are breached, such as cumulative default rates. The senior/subordinate structure can influence modification and forbearance activities, as discussed in the testimony.

In contrast, the contractual obligations for private-label mortgage-backed securities issued during the financial crisis created more explicit barriers to modification. For example, certain governing securitization documents contained restrictions on the amount of underlying mortgage loans that could be modified (frequently limited to 5 percent of the outstanding pool). Other governing documents, namely the Pooling and Servicing Agreements, often required the servicer to take actions that would be in the best interest of the investors and required servicers to determine whether a modification would benefit the securitization on a present-value basis. Additionally, mortgage-backed securities had certain restrictions under the real estate investment trust (REIT) structure. These are just some of the barriers to modification faced by mortgage borrowers whose loans were securitized in private label mortgage-backed securities.

Q.1.d. What would be required to offer borrowers with securitized loans the same options that can be afforded to borrowers whose loans were not securitized?

A.1.d. The FDIC continues to seek solutions to challenges in the student lending area. The FDIC, jointly with the FRB and OCC, recently issued a statement to the institutions we supervise to clarify that we support efforts by banks to work with student loan borrowers and our current regulatory guidance permits this activity. In addition, the statement makes clear FDIC-supervised institutions should be transparent in their dealings with borrowers and make certain that borrowers are aware of the availability of workout programs and associated eligibility criteria. Additionally, the FDIC has formed a working group to engage various stakeholders, including private student loan lenders and consumer groups to determine whether other enhancements are needed.

Q.2. As a voting member agency of the Financial Stability Oversight Council, I am interested in your views on how you assess whether an entity would meet the criteria to be designated a systemically important financial institutions (SIFI). Specifically, given its extremely large footprint in servicing Direct, FFELP, and private student loans, what would be the broader impact on consumers and markets if SLM Corp. (Sallie Mae) were to fail?

A.2. Section 113 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) authorizes the Financial Stability Oversight Council (FSOC) to determine that a nonbank financial company shall be supervised by the FRB and shall be subject to prudential standards, in accordance with Title I of the Dodd-Frank Act, if the FSOC determines that material financial distress at the nonbank financial company, or the nature, scope, size, scale, concentration, interconnectedness, or mix of the activities of the nonbank financial company, could pose a threat to the financial stability of the United States. The final rule and the interpretive guidance describe the manner in which the FSOC intends to apply the statutory standards and considerations, and the processes and procedures that the FSOC intends to follow, in making determinations under section 113 of the Dodd-Frank Act. While the FDIC does not comment on open and operating institutions, the impact of any major consumer loan servicer would depend on market conditions at the time and the company's ability to sell or transfer its balance sheet components and servicing platforms.

Q.3.a. In October 2012, the Consumer Financial Protection Bureau issued a report about problems servicemembers face when utilizing benefits guaranteed by Federal law, even on Government-guaranteed student loans. Your agency supervises institutions with FFELP portfolios.

Have you focused on these portfolios in your examinations?

A.3.a. The FDIC's compliance examination process is risk-focused, including its review of student loans and related practices. As part of that review, examiners assess compliance with Federal laws designed to protect servicemembers. Examples of Federal laws that provide special protections to servicemembers are the Servicemembers Civil Relief Act (SCRA) and the Military Lending Act (MLA). These laws could involve student loans as well as other types of loans. SCRA and MLA compliance is an important examination priority for the FDIC given the potential for consumer harm. SCRA is included in the scope of all compliance examinations conducted by the FDIC. Through the risk-based examination process, examiners communicate this emphasis to our supervised banks during the review of the bank's compliance management system and transaction testing.

Additionally, the FDIC's examination process also includes a review of consumer protection laws and regulations under its authority to the extent those rules are applicable to PSL and Family Federal Education Loan Program (FFELP) portfolios. However, the Truth-in-Lending Act exempts loans made, insured, or guaranteed under title IV of the Higher Education Act of 1965, which includes FFELP portfolios. In general, the regulatory review of an institution's policies and practices with regard to student lending encompasses the bank's origination and servicing aspects for PSLs and focuses on servicing with regard to the federally guaranteed student loans.

Q.3.b. To what extent have you determined that servicemembers are victims of unfair or deceptive practices as it regards to student loan benefits?

A.3.b. The FDIC takes enforcement actions to address violations of the SCRA, MLA, section 5 of the Federal Trade Commission Act (Section 5) regarding unfair and deceptive acts and practices, and other applicable laws and regulations, including those that involve an institution's policies and practices affecting student loans. Since January 2012, the FDIC has addressed SCRA violations (generally) in 55 examinations and FDIC-supervised institutions have reimbursed, pursuant to enforcement actions, a total of approximately $154,000 to 358 servicemembers for violations of SCRA.

Q.3.c. Are you confident that your supervised institutions are in compliance with the SCRA?

A.3.c. Based on our compliance examination procedures and processes, which include SCRA compliance reviews, we believe that most of the institutions we supervise comply with the SCRA. Where we find violations, we take appropriate corrective action.

The primary responsibility for compliance with the SCRA rests with an institution's board and management. The FDIC's compliance examination process assesses how well a financial institution manages compliance with Federal consumer protection laws and regulations starting with a top-down, comprehensive evaluation of the compliance management system (CMS) used by the financial institution to identify, monitor, and manage its compliance responsibilities and risks, including those associated with the SCRA. The goal of a risk-focused, process-oriented examination is to direct resources toward areas with higher degrees of risk.

The FDIC specifically examines its institutions for compliance with the SCRA, using transaction sampling and other techniques. Through our policies, guidance, and examination procedures, the FDIC communicates to our supervised institutions the importance of SCRA compliance. The FDIC may initiate informal or formal corrective action when an insured depository institution is found to be in an unsatisfactory condition, based on unfair or deceptive acts or practices. Violations of consumer protection laws and regulations and/or a bank's failure to maintain a satisfactory CMS may also result in these types of corrective action.

Q.3.d. To what extent have you shared these results with the Department of Education and the Department of Justice?

A.3.d. Subject to the limitations of the Right to Financial Privacy Act (RFPA) and FDIC regulations regarding the sharing of confidential supervisory information, 12 C.F.R. Part 309 (Part 309), the FDIC shares examination information with other Federal financial institution regulators and with the Department of Justice (DOJ). DOJ has exclusive enforcement authority over criminal violations and has concurrent authority over violations of Federal fair lending laws and the SCRA. If the FDIC uncovers evidence that parties over which DOJ has exclusive or concurrent authority may have violated these laws, the FDIC shares with the DOJ relevant information related to these potential violations to the extent permitted by the RFPA, Part 309, and interagency memoranda of understanding. Because the Department of Education (DOE) does not have enforcement jurisdiction over financial institutions, such examination information is not typically shared with DOE.

For compliance examinations, the review of loan servicing by an institution focuses on ensuring that the agreement is consistent with governing laws and is implemented as agreed to avoid any SCRA or Section 5 violations.

Q.4.a. The CFPB's May 2013 report, Student Loan Affordability: Analysis of Public Input on Impact and Solutions, raised concerns about the effect of unsustainable levels of student debt. Heavy student loan burdens not only deplete available resources but can also limit the career opportunities of young graduates who must earn salaries that can repay tens or hundreds of thousands of dollars in debt. And, if borrowers fall behind the resulting damage to their credit can further limit access to financing for a home, car, or even daily purchases. Homebuilders and mortgage originators have already noted a decrease in the volume of home purchases by young people, and practitioners in careers that may offer less compensation, including public service and family medicine, have noted that young people are now gravitating toward more lucrative careers to pay back large volumes of debt.

Has your agency observed differences in home loans, auto loans, and other extensions of credit to young borrowers?

A.4.a. Insured depository institutions report information on their financial condition and operations in their quarterly Call Report filings. All data, including information on loans, are reported in aggregate and do not contain any demographic or other identifying characteristics.

Q.4.b. Given the risks associated with student loans, which are typically underwritten without an extensive borrower credit history, and the relatively more secure, collateralized loans made for homes, cars, and other consumer products, how do you project that the rising burden of student debt will impact the balance sheets of the institutions that you regulate in the long term?

A.4.b. Institutions supervised by the FDIC hold about $14 billion in PSLs, representing less than 10 percent of the estimated $150 billion in PSLs outstanding. This amount represents a very small portion of the $14.4 trillion in total industry assets and $7.7 trillion in total loans outstanding. PSL originations are currently about $8 billion per year.

The FDIC supervises PSL lenders using the same framework of safety and soundness, and consumer protection rules, policies, and guidance, as for other loan categories. We expect insured institutions to prudently underwrite PSLs and comply with outstanding rules and guidance. PSLs typically are required by originators to have a cosigner. In 2011, over 90 percent of these loans were cosigned. According to TransUnion, the 90-day and over delinquency rate for PSLs was 5.33 percent as of March 2012.

Q.4.c. In your experience, do the private student lenders you regulate extend, or offer to extend, other forms of credit to borrowers of private student loans? How do incentives for customer service and sound financial practices change for Private student lenders that do not offer a full suite of financial products?

A.4.c. One of the larger lenders that the FDIC supervises offers a variety of credit products, including credit cards, personal loans, and home loans. Specific data quantifying the number of accounts and balances of private student loans holding multiple products by this institution are not publicly available.

Another large lender which originates PSLs does not offer other forms of credit to PSL borrowers.

As a general matter, financial institutions' approaches to customer service and financial practices are motivated by a desire to grow and maintain a strong and well-regarded business. Moreover, as mentioned under our response to question 8, we examine the institutions we supervise for safety and soundness and for compliance with all applicable laws, rules, and guidance.

Q.5. Your testimony cited OCC guidance issued in 2010 as the standard that regulators use when determining the soundness of bank's decision to work with a troubled borrower. The guidance states that once repayment has begun "private student loans should not be treated differently from other consumer loans except in cases where the borrower returns to school." It further states the loan modifications should be considered for "long-term hardships" and may "temporarily or permanently" reduce interest rates to lower payments but should not include terms that "delay recognition of the problem credit."

How often does each of the private student lenders that you supervise engage in loan modifications for borrowers who are in long-term hardship situations? How often does each of the lenders grant additional forbearance beyond the 6-month introductory period?

A.5. The FDIC's testimony cited the interagency Retail Credit Policy, which provides significant flexibility for institutions to offer prudent workout arrangements tailored to their PSL portfolios and borrower circumstances. In particular, the Retail Credit Policy states that it is the institution's responsibility to establish its own policies for workouts suitable for their portfolio. There is nothing barring FDIC-supervised institutions from engaging in workouts, and many institutions offer various types of workout options. Repayment options are disclosed in application or solicitation materials as well as in the promissory note. Each institution has its own policies that establish how the bank will work with borrowers who are facing financial challenges.

The institutions we supervise do not usually publicly disclose the full scope of modification and restructuring options available. Nonetheless, the two largest FDIC-supervised institutions that offer PSLs described their features and borrower benefits in their respective letters to the CFPB, both dated April 8, 2013, responding to the Request for Information Regarding an Initiative to Promote Student Loan Affordability (Docket No. CFPB–2013–0004).

Q.6. In your testimony, you described that institutions should constructively work with private student loan borrowers to conduct modifications in a safe and sound manner. Given that loan modifications might increase the net present value of certain troubled loans, how does your agency plan to increase the pace of loan modification activity among its supervised institutions?

A.6. The FDIC encourages the institutions we supervise to work with borrowers who are unable to meet the contractual payments on their loans. We have communicated to banks during onsite examinations, through written guidance, and at outreach events that prudent workout arrangements are generally in the best long-term interest of both the bank and the borrower, and that examiners will not criticize banks for engaging in prudent workout arrangements, even if it results in adverse asset classifications or TDR accounting treatment.

We believe the Retail Credit Policy provides institutions with the flexibility needed to help borrowers overcome temporary financial difficulties through extensions, deferrals, renewals, and re-writes of closed-end loans, which include student loans. To emphasize this point, the FDIC, along with the FRB and OCC, recently issued a statement to the banks we supervise to clarify that we support efforts by banks to work with student loan borrowers and that our current regulatory guidance permits this activity.

Q.7. Please provide any interpretive guidance (*e.g.,* for use by examiners, supervised institutions) on the Uniform Retail Classification and Account Management Policy that is specific to private student loans. Describe how your interpretation differs from the guidance used by other prudential regulators.

A.7. The Federal financial institution regulatory agencies strive to consistently apply the Retail Credit Policy. On July 25, 2013, the FDIC, jointly with the FRB and the OCC, issued a statement encouraging banks to work prudently with student loan borrowers who are experiencing financial difficulties.

Q.8. What is your supervisory approach when conducting examinations of Federal and private student loan servicing activities? What are the risk factors that you look for? Do you have publicly available manuals and guidance that cover student loan servicing? Have you utilized complaints submitted to the CFPB and the Department of Education to scope your exams?

A.8. The FDIC supervises PSL lenders using the same framework of safety and soundness and consumer protection rules, policies, and guidance as for other loan categories. In addition to the examination scope and procedures described in Ms. Eberley's testimony, the FDIC reviews loan servicing activities, in particular, for safety and soundness and consumer compliance issues. Safety and soundness concerns include those related to the bank's valuation of its servicing rights (assets) and adherence to governing loan servicing documents. In general, financial institutions engaged in servicing activities, including student loan servicing, should have policies and procedures, operational support, and appropriate audit and other quality controls to ensure performance under servicing agreements.

The FDIC's compliance examination process assesses how well each financial institution manages compliance with Federal consumer protection laws and regulations. In general, our examinations for compliance with the Fair Debt Collection Practices Act, Equal Credit Opportunity Act, and Section 5 of the Federal Trade Commission (FTC) Act, include review of distressed loans, including student loans, to ensure equal treatment, adherence to debt collection requirements, and that no unfair or deceptive acts or practices are involved in attempting to collect debts from distressed borrowers.

The FDIC's regulatory assessment of the supervised institution's compliance with the various consumer protection laws and regulations typically includes review of consumer complaints, pending litigation, the oversight and use of third-party servicers, due diligence on the schools the institutions work with to provide student loans (*e.g.,* reputation, accreditations, for-profit/not-for-profit), marketing practices, and the institution's policies and procedures. These procedures apply to student loans as well as other consumer loans.

Consumer complaints play a key role in the detection of consumer protection risks, including those involving student loan issues. Examiners review various sources of complaint information, such as the CFPB, FDIC, FTC, institutional, and various media sources. The FDIC's Consumer Affairs Branch continues to monitor and identify potential areas of concern through the complaint investigation process. In analyzing and collecting information about how these products may impact consumers, we are able to see the impact these new products may have on consumers.

Q.9. Compared to Direct Loans, it is generally more cumbersome for Federal student loan borrowers to enroll in income-based repayment programs. Many institutions you supervise have significant FFELP holdings. How would you generally assess the ability of your supervised entities to make borrowers aware of and successfully enroll them in income-based repayment options?

A.9. Not all FDIC-supervised banks have FFELP holdings, choosing instead to sell their existing FFELP portfolios. One of the major FDIC-supervised student lenders relies on affiliates to service its FFELP loan portfolio. This institution communicates to its customers, making them aware of repayment options through an interactive Web site that offers information regarding student loan applications, loan repayment advice, and forbearance options, among other things.

Q.10.a. Your testimony focused heavily on forbearance as a method of relief for private student loan borrowers. But the volume and terms of private student loans issued in the years leading up to the financial crisis indicate that many of these loans may not be sustainable even after forbearance periods. The Consumer Financial Protection Bureau's July 2012 report documented a 400 percent increase in the volume of private student loan debt originated between 2001 and 2008, and 2008 originations surpassed $20 billion. The report also shows that, from 2005 to 2008, undergraduate and graduate borrowers of private student loans took on debt that exceeded their estimated tuition and fees, and in some years more than 30 percent of loans were made directly to students with no certification of enrollment from their academic institution. The heavy debt burden that was created in these few years is not just unsustainable by dollar volume, but also in loan terms. Loans were often variable rate loans with initial interest rates ranging from 3 percent to more than 16 percent.

Given these extremely unfavorable loan terms that were made to a larger number of borrowers, presumably including more students from limited financial means, do loans originated between 2001 and 2008 comply with your standards for safety and soundness?

A.10.a. Many borrowers who have student loan debt have FSLs and PSLs, as the rising cost of education often required additional borrowing to supplement college savings, scholarships, and grants used to pay for higher education. However, some mechanisms, such as extending loans only for accredited educational programs and directly transmitting the funds to the school, that were in place to prevent overlending to an individual were circumvented during the years leading up to the recent financial crisis. As mentioned in our response to question 8, the FDIC examines banks for safety and soundness and consumer compliance concerns, and would be critical if objectionable conditions or practices are found.

Q.10.b. How would refinancing the highest-cost loans to reflect borrowers' current characteristics affect the soundness of a regulated institution's balance sheet in the short and long term?

A.10.b. FDIC supervised institutions routinely offer new or renewed loans and, for variable rate loans, periodically adjust the loan rate, based on current market rates. In general, financial institutions actively manage the asset and liability mix of their balance sheet. Based on market-based pricing and other balance sheet management strategies used by financial institutions, as well as the small overall volume of PSLs held by banks, we do not expect refinancing of PSL loans to have a material impact on the balance sheet condition of the banks that we supervise.

Q.11. Recently, SLM Corp. announced that it would make significant changes to its corporate structure. As the prudential regulator of Sallie Mae Bank, what is your view on these changes?

A.11. The FDIC does not comment publicly on open banks it supervises. Published reports indicate that SLM Corporation plans to divide its existing businesses into two, separate, publicly traded entities that would each initially be owned by its existing shareholders. It is expected the separation, if completed, would be effected via a tax-free distribution of the holding company's common stock to Sallie Mae's shareholders.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR MANCHIN FROM DOREEN R. EBERLEY

Q.1. In rural towns across the country, there is a chronic shortage of primary care health professionals. Not just doctors, but nurses and others. According to the American Medical Association, student debt may be a barrier to practicing in underserved communities.

This problem extends beyond health professionals. I hear from West Virginians across my State that the best teachers are retiring and that poorer districts are having a tough time bringing in young people to take their places. So many rural families want their kids to go to college, but they worry about the impacts of high levels of student loan debt?

In your opinion, how will rural areas survive without critical professions like doctors, nurses, and teachers? What are you doing to make sure that the burden of student debt isn't disproportionately shouldered by rural areas?

A.1. PSLs issued by financial institutions help individuals, who might not otherwise have the resources, to obtain a college education and the subsequent benefits associated with a college degree, both financial and nonfinancial. At the time a student loan is made, it is without regard to where future employment opportunities may be located.

As the primary regulator of small community banks, the FDIC understands the unique financial challenges in rural areas. Rural areas in particular struggle to attract and retain young professionals. The FDIC, jointly with the FRB and OCC, recently issued a statement encouraging banks to work constructively with student loan borrowers experiencing financial difficulties, and clarifying that our current regulatory guidance permits this activity.

Q.2. It does not make any sense that, under our current system, students are forced to pay high interest rates on Federal student loans when everyone else in the economy benefits from low borrowing costs on everything else. And if we don't act by July lst, every Federal loan will have an interest rate of at least 6.8 percent in 2013, while T-bill rates stay near historic lows.

Not only would moving to a market-based rate allow students to benefit from cheaper borrowing when everyone else can, I expect that PSL lenders would, in order to remain competitive, lower their rates as well. Under the current system, private lenders know that we have created artificial benchmarks for these rates, so private lenders can always keep their rates unnecessarily high.

How do you believe that implementing a market-based rate for Federal loan programs would affect the private loan market? Wouldn't allowing Federal rates to fall during times of cheap borrowing—such as today—force private borrowers to lower their interest rates to remain competitive?

A.2. In general, students exhaust other financial options, such as grants and FSLs, before applying for PSLs, which are issued by financial institutions. Rates for the two types of student loans—FSLs and PSLs—are determined through different processes. PSLs have a market-driven rate, which reflects the supply and demand for funds, whereas FSLs have rates currently set by statute. The rates charged on loans are set by individual institutions to cover funding and overhead expenses and reflect a risk premium on the loans granted based on the risk profile of the student borrower and cosigner, if any. PSLs are unsecured (no collateral protection) and expose the institution to risk of loss for the entire outstanding loan balance in default. Loan rates for PSLs are set to reflect this risk and are already at market rates. Therefore, it is unlikely that a change in a market-based rate for Federal loans to substantially affect PSLs.

ADDITIONAL MATERIAL SUPPLIED FOR THE RECORD

CBA | CONSUMER BANKERS ASSOCIATION

The Voice of the Retail Banking Industry

June 24, 2013

The Honorable Tim Johnson Chairman U.S. Senate Committee on Banking, Housing, and Urban Affairs 534 Dirksen Senate Office Building Washington, DC 20510	The Honorable Mike Crapo Ranking Member U.S. Senate Committee on Banking, Housing, and Urban Affairs 534 Dirksen Senate Office Building Washington, DC 20510

Dear Chairman Johnson and Ranking Member Crapo:

The Consumer Bankers Association (CBA) is Washington's public policy leader for private student lenders and appreciates the opportunity to share some of our views with the Senate Banking Committee for its hearing entitled "Private Student Loans: A Regulatory Perspective." CBA's Education Funding Committee represents all the major bank participants in the private student loan business and is focused on promoting a private student loan market that is ethical, fair and reliable.

CBA and its member institutions recognize the value of higher education. During all economic periods, those with a college degree will have a better opportunity at securing a job and will have higher earnings than those without a college degree. A 2009 report by the U.S. Bureau of Labor Statistics (BLS) highlights lower unemployment for those with bachelor's degrees.[1] It points out higher earnings – "this amount is 1.8 times the average amount earned by those with only a high school diploma."[2]

Unfortunately, college tuition has risen 1,120 percent since 1978.[3] This leaves many students and families with the difficult question of how to finance higher education. Families and students are covering the cost of higher education through grants, financial aid, scholarships, college savings plans and income. When these options do not cover the full cost of attendance, families and students then turn to loans.

The federal government is now originating 93 percent of today's loans, but private lenders play a critical role in bridging the financing gap when aid, scholarships and Stafford loans do not meet a student's needs. In fact, the 2012 Consumer Financial Protection Bureau (CFPB)/Department of Education joint report, "Private Student Loans" called these products "useful tools in the education finance toolkit"[4]

We have seen an evolution in the private market. Today, most if not all, of the top private lenders offer fixed-rate products that are competitively priced and broadly available. Variable-rate products are also available at historically rates for those consumers who choose to take advantage of the benefits that variable rates can provide.

Innovation and more competition in the marketplace have directly benefited consumers seeking private loans tailored to their needs. The CFPB acknowledged that lenders are now offering products, which, in some cases, are "an appropriate substitute for an unsubsidized Stafford loan."[6]

CBA strongly believes consumers should have access to the necessary information to shop and compare loan products best suited for their needs. For example, private loan prices and terms work better than PLUS loans for some students. PLUS Loans have a 7.9 percent fixed interest rate with a 4 percent origination fee. Most of today's private loans do not have origination fees, and a number of lenders offer fixed-rate products with lower rates for qualified borrowers.

CBA's members are in the business of helping students and families meet their higher education financing needs, and they are doing it in a responsible and effective manner. This can be observed through the performance of these loans. According to the CFPB, private student loans have a default rate of 5.3 percent.[5] In September 2012, the Department of Education announced a 13.5 percent three-year default rate for Federal student loans.[6]

Private student loans contain the most important consumer protection because they undergo rigorous underwriting and a full ability-to-repay assessment before the loan is even made.

As the former Deputy Director of the CFPB Raj Date puts it, "People who are going to lend money should care about getting paid back. And if you care about getting paid back, you should inquire about, and evaluate, a borrower's ability to pay you back. This should not be controversial."[8]

Underwriting of private student loans helps ensure customers do not over-borrow. While this has led to lower default rates, private lenders also have tools to help borrowers. Private lenders continually do outreach to and educate borrowers while in school and increase contact before graduation to help them with the transition from school to the workforce.

In addition, borrowers are allowed a six-month grace period before having to begin payments and can also receive another six months of extended grace (hardship forbearance). Private lenders can also grant subsequent forbearances as permitted by regulatory guidance. We believe more discussion on ways to assist troubled borrowers is important. CBA recently sent a letter to the prudential banking regulators asking them to review several suggested ways to help borrowers who are "experiencing financial difficulty who are recent graduates, or early in their careers, when it is more difficult to enter the labor force and establish financial independence and stability."[8]

Conclusion

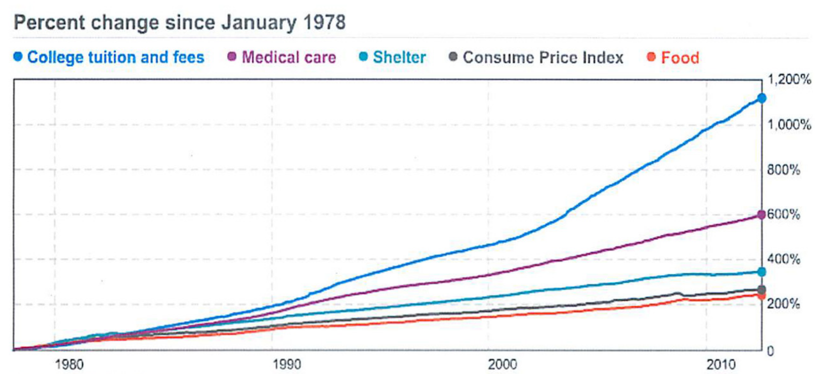
Higher education is critical for the future competitiveness of our country. Data clearly shows a degree opens the doors for future employment and higher earnings potential. Private lenders, while a small portion of the market, are leading the way in responsible lending. Through competition and innovation, we continue to see more loan options for students.

CBA urges policymakers to focus their efforts on ways to make college more affordable and accessible for all. During discussions on this topic, it is important that all stakeholders recognize the valuable role banks are playing in helping students and families meet their higher education financing needs.

CBA looks forward to continuing to work with Congress, students and all stakeholders on these important issues.

Sincerely,

Richard Hunt
President and CEO
Consumer Bankers Association



Source: Bloomberg, Labor Department

1. http://www.bls.gov/spotlight/2010/college/pdf/college.pdf (pg. 3) See chart in appendix
2. http://www.bls.gov/spotlight/2010/college/pdf/college.pdf (pg. 4) See chart in appendix
3. http://www.decisionsonevidence.com/2012/08/cost-of-college-degree-soars-12-fold-since-1978/
4. "Private Student Loans" report by the CFPB and the Department of Education (page 11) http://files.consumerfinance.gov/f/201207_cfpb_Reports_Private-Student-Loans.pdf
5. Private Student Loans" report by the CFPB and the Department of Education (page 16) http://files.consumerfinance.gov/f/201207_cfpb_Reports_Private-Student-Loans.pdf
6. http://www.ed.gov/news/press-releases/first-official-three-year-student-loan-default-rates-published
7. Testimony of CFPB Deputy Director Raj Date, July 19, 2012. http://financialservices.house.gov/UploadedFiles/HHRG-112-BA15-WState-RDate-20120719.pdf
8. CBA Letter to OCC, FDIC & Fed Requesting Flexibility on Student Loan Repayment Options (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

THE FINANCIAL SERVICES ROUNDTABLE

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June 25, 2013

The Honorable Tim Johnson (D-SD)
Chairman
Senate Banking Committee
U.S. Senate
Washington, D.C. 20510

The Honorable Michael Crapo (R-ID)
Ranking Member
Senate Banking Commitee
U.S. Senate
Washington, D.C. 20510

Re: Private Student Loans

Dear Chairman Johnson and Ranking Member Crapo:

The Financial Services Roundtable supports the public policy goal of ensuring that college or an advanced education is available to every American and believes it is crucial to the future competitiveness of our nation. Education loans, along with college savings plans and federal assistance, such as tax credits and Pell grants help to make college affordable and accessible for many Americans.

Private lenders provide loans and services to help cover the cost of tuition and educational expenses and create access for millions of American families each year. Private student loans being originated today typically provide borrowers with the choice of a fixed rate or variable rate option, which allows the consumer to select the option that best works for them, and they are largely 100% school certified, ensuring borrowing levels do not exceed the cost of education. There is competition in the private student loan marketplace, which benefits students and their families. Those same benefits of competition should be available to all students no matter whether they use private or federal student loans. Private sector competition has supported technological innovations and the improvement of services and products to the benefit of students.

There is no question that the ever increasing cost of education is making it harder for students to afford college. Between 1986 and 2011, inflation increased by 115% but college tuition increased by over 498% - outpacing inflation by more than 4 times the rate. Although federal Pell Grant assistance has increased significantly during this period, reliance on student loans—in particular federal student loans—has increased dramatically. The Department of Education ("DOE") projects that over 25 million Federal Direct Student Loans will be made this year totaling over $124 billion. In addition to these Direct Loans to students and parents, private sector lenders will make approximately $8 billion in loans — or about 6 percent of the overall total.

A 2013 student loan study conducted by TransUnion found that federal loans made up 92% of all student loan accounts and 86% of overall balances. Between 2007 and 2012, federal loan balances jumped 97% while private loan balances only rose 4%. From 2007 to 2012, federal student loan delinquencies rose 27%, while private loan delinquency rates actually dropped 2% in that same timeframe. The 90-day delinquency rate for federal loans was 12.31% as of March 2012, compared to 5.33% for private loans. Since March 2012, the federal loan delinquency rate has increased and the private loan delinquency rate has continued to decline. Accordingly, this year the federal government will lend 20 times more than private lenders to students and parents without any test of ability to pay, and the government fully knows that nearly one in five of them will not be able to pay the taxpayer back.

In sharp contrast, the loans made by the private sector default at less than one third of that rate continuing the sustained trend towards lower private loan delinquencies/defaults driven by private loan underwriting and delinquency management. If one defines risk as a question of one's ability to pay off the loan, then on average federal student loans appear statistically far riskier to far more borrowers than private loans. The dramatically lower private education loan default rate is a result of the fact that the private sector's interest are aligned with students, since the only way lenders can earn any return and protect their investment is if the student gets value for their education resulting in their ability to repay that investment in their education.

A side-by-side comparison of the private and federal student loan markets reveals that private sector lenders have multiple regulators, publicly disclose extensive loan performance data, and have been scrutinized for years by their regulators, Congress, and the media. In contrast the U.S. Department of Education operates with very little transparency. More importantly, little is known about the hundreds of billions in loans that the DOE makes to students and parents. The year to year costs to the American taxpayers are never reconciled and are later masked in the Federal Budget.

In closing, private student loans are a viable alternative and/or supplement to federal student loans, the Roundtable believes that private student loan industry plays an important role in helping students reach their education aspirations. It is important to recognize that lenders must receive a fair return on student loans, since that fair return creates the programs, value, and competition which improves responsible access to credit and higher education. We look forward to continuing this important conversation with students, schools and universities, and Congress.

Best Regards,

Scott Talbott
Senior Vice President, Public Policy