MAY 8, 2013

Student Loan Affordability

Analysis of Public Input on Impact and Solutions

Consumer Financial Protection Bureau

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1. Executive Summary

- In October 2012, a CFPB report noted that many borrowers of private student loans in periods of temporary hardship have been unable to negotiate affordable repayment plans with their lenders and servicers. Unlike federal student loans, private student loans generally do not allow for affordable repayment options, such as those where payments are contingent on borrower income. The lack of options may lead to damaged credit, potentially inhibiting the borrower's future economic participation. In addition, even borrowers who were not struggling noted that they have been unable to refinance their high-rate student loans in order to lower their monthly payments.

- 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. A broad cross-section of organizations and individuals submitted comments to the CFPB discussing the potential impact of rising student debt levels on the economy and society. These comments described the impacts of high student debt burdens on homeownership, small business formation, retirement security, and other sectors. These comments supplement recent concerns raised by a number of monitors of the financial system.

- In 2008, as credit markets showed signs of distress, policymakers intervened in the student loan marketplace to facilitate lending by private financial institutions. Many borrowers taking on these loans graduated in a difficult economy and are struggling to manage high student debt burdens.

- Commenters suggested a number of options for policymakers to spur affordable repayment options on private student loans so that a substantial number of consumers might participate more fully in the economy. Some commenters put forth potential principles should policymakers pursue programs that would encourage lenders to make concessions and restructure loans. Commenters also described opportunities for private student loan borrowers to repair their credit if they successfully repay a restructured loan. Others suggested mechanisms to jumpstart a refinance market, so that borrowers might better take advantage of today's interest rate environment and their improved credit profile.

2. About This Report

The Dodd-Frank Wall Street Reform and Consumer Protection Act established a student loan ombudsman within the Consumer Financial Protection Bureau to focus on student loans. Pursuant to the Act, the ombudsman shall conduct analysis on input from borrowers, prepare an annual report, and make appropriate recommendations to policymakers, including the Director of the Consumer Financial Protection Bureau, the Secretary of the Treasury, and the Secretary of Education.

This report analyzes and discusses public comments submitted in response to a Request for Information Regarding an Initiative to Promote Student Loan Affordability published in the *Federal Register* in February 2013 (Docket ID: CFPB-2013-004). The notice detailed a series of topics and questions to elicit feedback from the public, including:

- How student loan burdens might impact the broader economy;
- How distressed borrowers manage their student loan obligations;
- What options currently exist for borrowers to lower their monthly payments on student loans;
- Examples of successful alternate repayment programs in other markets and which features could apply to the market for private student loans; and
- The most effective mechanisms for communicating with distressed borrowers.

Members of the public, including financial institutions, colleges and universities, professional associations representing health professionals and educators, housing finance experts, students, and families were encouraged to submit comments. Interest level from the public was high. More than 28,000 comments were submitted during the comment period.[1] In subsequent sections of this report, we first analyze how these comments describe the impact of student debt on other sectors of the economy and society. We then detail some of the recent interventions by policymakers in the student loan market in the past five years. Finally, we discuss some of the policy options raised by those submitting public comments.

[1] Due to the large number of comments, the CFPB has compiled them in formats to facilitate data analysis. See http://1.usa.gov/ZxLjSc.

3. Analysis and Discussion of Public Comments on Student Loan Affordability

There are more than 38 million student loan borrowers with over $1.1 trillion in outstanding debt.[2] The majority of the market consists of loans originated by financial institutions and the government under Title IV of the Higher Education Act. The remainder of the market consists of private student loans.

In July 2012, the Director of the Consumer Financial Protection Bureau (CFPB) and the Secretary of Education submitted a report to Congress detailing the private student loan market.[3] The report found that, as of the end of 2011, there were more than $8 billion in defaulted private student loan balances, with even more in delinquency.[4] Federal student loans frequently provide for income-based repayment options for borrowers with partial financial hardship, as well as rehabilitation options for borrowers in default. In general, private student loans do not offer similar modified repayment options.

In October 2012, the CFPB published an additional report, as required by the Dodd-Frank Wall Street Reform and Consumer Protection Act.[5] The report analyzed complaints and other input from private student loan borrowers and noted that many private student loan borrowers reported difficulties negotiating repayment plans with their lenders and servicers in times of financial difficulty. The report further noted that borrowers of both federal and private student loans reported difficulties finding refinance options and were thus prevented in many cases from taking advantage of historically low interest rates. Pursuant to the Dodd-Frank Act, the report included recommendations to the Director of the CFPB, the Secretary of the Treasury, the Secretary of Education, and Congress. One of these recommendations encouraged policymakers to

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[2] Consumer Financial Protection Bureau and Department of Education, *Report on Private Student Loans* (2012); U.S. Department of Education, *Federal Student Aid Annual Report for Fiscal Year 2012* (2012).
[3] Consumer Financial Protection Bureau and Department of Education, *Report on Private Student Loans* (2012)
[4] The precise definition of delinquency and default may vary across private student loan programs. Generally, a delinquent status refers to a loan where the borrower has not paid as agreed, while a default status refers to the point where the creditor recognizes the loss of the unpaid balance for accounting purposes.
[5] Consumer Financial Protection Bureau, *Annual Report of the CFPB Student Loan Ombudsman* (2012).

identify options to spur the availability of loan modification and refinance options for private student loan borrowers.

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. Subsequent sections of this report discuss various policy options put forth by the public to promote greater affordability of private student loan burdens.

Part One: Potential Impact of Student Debt Burdens

Americans with college degrees enjoy significant benefits from their educational attainment, including increased likelihood of employment and higher wages. Many of the public comments received in response to the request for information recognized these important benefits. However, they also noted that rising college costs and strained family finances have caused debt burdens to rise significantly. While many of the public comments received in response to our request for information focused on the challenges individual consumers face when managing high student loan balances, a broad cross-section of organizations and individuals also discussed the impact of rising student debt on the economy and society. The impacts described in these comments are consistent with and supplement concerns previously raised by the CFPB and other monitors of the financial system.[6]

Respondents described how monthly student loan payments may crowd out other types of consumer spending and may ultimately shape the choices young graduates make about their careers and the communities in which they live. Researchers and policymakers can find a range of potential impacts of high debt burdens described in the public comments. Below we discuss some of the themes found in these comments.

Household Formation and Homeownership

Generally, high student debt burdens limit borrowers' ability to take on new financial obligations. Between 2007 and 2010, the average student loan balance for households with student debt climbed by nearly 15 percent, even as households have deleveraged and other classes of consumer debt have declined.[7] Over this period of time, younger consumers have increasingly shied away from forming new households.[8] Census data reveals that nearly 6 million Americans ages 25 to 34 lived with their parents in 2011, a sharp increase from 4.7 million in 2007.[9] We heard from respondents citing research from the Federal Reserve Bank of Cleveland, which showed that three-quarters of the overall shortfall in household formation can be attributed to

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[6] See, for example, the minutes of the March 2013 meeting of the Federal Reserve System's Federal Open Market Committee, the 2013 Annual Report of the Financial Stability Oversight Council, and the 2012 Annual Report of the Department of the Treasury's Office of Financial Research. These reports note the potential effect of student debt on household spending and demand for mortgage credit.

[7] Pew Research Center, *Pew Social Trends: A Record One-in-Five Households Now Owe Student Loan Debt* (2012).

[8] The U.S. Census Bureau defines a household as consisting "of all the people who occupy a housing unit." Occupants may be homeowners or renters and need not be related. A new household is formed when an occupant of an existing household leaves to form his or her own household. For more information, see Current Population Survey – Definitions, U.S. Census Bureau (2013).

[9] U.S. Census Bureau, *Income, Poverty and Health Insurance in the United States*, P60-239 (2011).

reductions among younger adults ages 18 to 34.[10] Some commenters suggested that this reduction is due to rising student debt levels, causing young adults to avoid the financial obligations necessary to start a family.[11]

As a growing number of young consumers have been unable to participate more fully in the housing marketplace, the segment of young consumers that remains interested in becoming first-time homebuyers may face new barriers to homeownership. The National Association of Home Builders (NAHB) stated that higher student debt burdens "impair the ability of recent college graduates to qualify for a loan."[12] 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.[13]

The National Association of Realtors wrote that first-time homebuyers typically rely heavily on savings to fund down payments.[14] For many borrowers, unmanageable student debt can make it difficult to accumulate any savings. According to data published by the National Association of Realtors, the first-time homebuyers' market share of existing homes was 30 percent in February 2013, compared to historical levels of 40 percent.[15]

Entrepreneurship and Small Business Formation

Commenters suggest that rising levels of student debt may have discrete impacts on American small business formation. According to these comments, student debt may suppress risk-taking and innovation by discouraging the formation of new businesses by young entrepreneurs.[16]

In submissions by coalitions of small businesses and startups, respondents pointed to a number of factors to explain the challenges posed by student debt.[17] For many young entrepreneurs, it is critical to invest capital to develop ideas, market products, and hire employees. Student debt burdens require these individuals to divert cash away from their businesses so they can make monthly student loan payments.[18] The U.S. Small Business Administration's Start-Up America initiative recommends that aspiring entrepreneurs with student loan debt enroll in an income-driven repayment plan in order to better manage their cash flow.[19] Although this option

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[10] See Comment ID: CFPB-2013-0004-7202.
[11] See, for example, Comment ID: CFPB-2013-0004-0072.
[12] See Comment ID: CFPB-2013-0004-1042.
[13] See Comment ID: CFPB-2013-0004-1042.
[14] See Comment ID: CFPB-2013-0004-6822.
[15] See Comment ID: CFPB-2013-0004-1042.
[16] See, for example, Comment ID: CFPB-2013-0004-7223 and CFPB-2013-0004-7195.
[17] See, for example, Comment ID: CFPB-2013-0004-7223.
[18] See, for example, Comment ID: CFPB-2013-0004-0945.
[19] Small Business Administration, *Startup America – Student Startup Plan* (2012). See http://www.sba.gov/startupamerica/student-startup-plan.

exists for most federal student loans, commenters note that private student loans generally do not feature this kind of flexibility in repayment.[20]

Others note that unmanageable student debt limits their ability to access small business credit. According to a submission by the Young Invincibles, eight percent of survey respondents with student debt stated that they were unable to start a business because they were denied a loan.[21]

Retirement Security

Although the economic effects of the behaviors described by commenters have the most immediate impacts on the housing and commercial sectors of the economy, some respondents suggest that rising student debt has increased financial pressure on older Americans as well, posing a risk to retirement security for many.

In its submission, AARP raised concerns that, for families headed by an American ages 50-64, "increasing debt threatens their ability to save for retirement or accumulate other assets, and may end up requiring them to delay retirement."[22] AARP cites data showing that a decline in housing values may have exacerbated an existing trend of increased borrowing by families with college-aged children.[23] Additionally, many families that historically would have absorbed the costs of a higher education have been forced to limit their contributions, shifting the costs of financing college to their children.

In addition to the near-term impact on retirement security for older Americans, rising student debt for younger consumers might delay participation in or reduce contributions to employer-sponsored retirement plans, leading to lost growth in those critical early years of labor force participation.[24] Recent research revealed that 50 percent of workers under the age of 30 have enrolled in their employer's 401(k) plan.[25] Forty-three percent of young workers do not save enough to receive a full employer match and are more likely to cash out their plans when changing jobs.[26]

Health Care

The United States faces a critical shortage of primary care providers – and this shortage is expected to continue to grow into the next decade. Population growth and aging will drive the demand for increased primary care, and recent estimates suggest that we will need as many as 52,000 additional primary care

[20] See, for example, Comment ID: CFPB-2013-0004-8400 and CFPB-2013-0004-0073.
[21] See Comment ID: CFPB-2013-0004-7195.
[22] See Comment ID: CFPB-2013-0004-6831.
[23] See, for example, Comment ID: CFPB-2013-0004-7426.
[24] See, for example, Comment ID: CFPB-2013-0004-7275.
[25] Northern Trust, *Line of Sight: The Path Forward – Engaging the Younger Employee in DC Plan Participation* (2011).
[26] Aon Hewitt, *Navigating the Path to Retirement: 2011 Universe Benchmarks Highlights* (2011); Northern Trust, *Line of Sight: The Path Forward – Engaging the Younger Employee in DC Plan Participation* (2011).

physicians by 2025.[27] The American Medical Association commented that high debt burdens can impact a medical student's choice of practice area, leading some to abandon geriatrics and family medicine in favor of more lucrative specialties, exacerbating the primary care shortage.[28]

The potential impact of student debt on healthcare professionals is not limited to physicians. Respondents include nurses and other practitioners that struggle to manage high student debt and low wage growth.[29]

Teaching

Many classroom teachers submitted letters detailing the impact of private student loans, which typically don't offer public service forgiveness programs and income-based repayment options available for federal student loans.[30] Teachers typically have low starting salaries[31] and slow income growth over time, circumstances that may ensure that the financial pressure caused by high student loan balances becomes a permanent feature in their lives.[32] One respondent has been a classroom teacher for 12 years and has over $75,000 in remaining student loan debt:

> *I teach, which I love to do, but, because I teach, I do not make enough money to get in front of my student loan debt… If I were to get rid of this debt I would be able to buy a house, take vacations, buy a car, and just spend more money in general that would help stimulate our economy.*[33]

A school district official expressed concerns about the lack of flexible repayment options for teachers with private student loans. He wrote that programs to make student debt more manageable could potentially lead to higher retention of quality teachers.[34]

Rural Areas

Rural communities present unique challenges for borrowers with student debt – obstacles that may dissuade young consumers from settling in or returning to rural areas after graduation.[35] These communities also require educated workers to serve as health care practitioners, teachers, business leaders, and other professions critical to local economies.

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[27] Petterson, S., Liaw, W., et. al, *Projecting US Primary Care Physician Workforce Needs: 2010-2025*, Ann Fam Med, Vol. 10, No. 6 (2012).
[28] See Comment ID: CFPB-2013-0004-0878.
[29] See, for example, Comment ID: CFPB-2013-0004-7191, CFPB-2013-0004-7670, and CFPB-2013-0004-7232.
[30] See, for example, Comment ID: CFPB-2013-0004-7542 and CFPB-2013-0004-7906.
[31] National Education Association, *2011-2012 Average Starting Teacher Salaries by State, Collective Bargaining/Member Advocacy Database* (2012).
[32] See, for example, Comment ID: CFPB-2013-0004-7542.
[33] See, for example, Comment ID: CFPB-2013-0004-8207.
[34] See, for example, Comment ID: CFPB-2013-0004-0038.
[35] See, for example, Comment ID: CFPB-2013-0004-1765.

Those college graduates that do elect to settle in rural communities face many of the same financial obstacles as their peers. As Rural Dynamics, Inc., a non-profit financial counseling organization based in Montana, noted, many of their clients do not earn enough "working in their field to pay the hundreds of dollars they owe on their student loans every month."[36]

In many rural communities, car ownership is a prerequisite for employment. Public transportation alternatives may be limited or non-existent. For some borrowers with high levels of student debt, car ownership may not be realistic – student debt may limit these borrowers' access to vehicle financing or inhibit cash flow to a degree that makes major purchases impossible.[37] For other young consumers with student debt, the idea of an additional financial obligation may have little appeal,[38] these borrowers may be debt-averse and the necessity of financing a vehicle purchase could dissuade them from settling in communities whose residents depend on car ownership.[39]

Lack of rental housing in some rural communities may have a similar impact on borrowers with student debt. Rural communities may have a more limited stock of rental housing, making homeownership a requirement for residents in these communities.[40]

Consequently, the need in rural areas to buy a home or a vehicle may be driving young college graduates with student debt away from these communities, exacerbating existing shortages of new primary care health practitioners, highly-qualified teachers and other young professionals on which these communities, like others, depend.

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36 See Comment ID: CFPB-2013-0004-8316.
37 See, for example, Comment ID: CFPB-2013-0004-7396.
38 See, for example, Comment ID: CFPB-2013-0004-8089.
39 See, for example, Comment ID: CFPB-2013-0004-1765.
40 Federal Reserve Bank of Atlanta, *Housing Trends in Rural Areas* (2012).

Part Two: Recent Interventions in the Student Loan Market

Due to the turmoil in the credit markets, the federal government enacted policies to jumpstart student lending activity by financial institutions. These programs played a significant role in ensuring that financial institutions could originate both government-guaranteed and other private student loans.

The ECASLA Authority

In 2008, financial institutions originated most new government-guaranteed federal student loans under the Federal Family Education Loan (FFEL) Program, in which the government provides subsidies and credit enhancements.[41] Many policymakers were concerned at the time that conditions in the capital markets would jeopardize access to post-secondary education.

On May 7, 2008, President George W. Bush signed the Ensuring Continued Access to Student Loans Act (ECASLA), 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. Lenders also received federal subsidies that guarantee them a minimum yield specified by law, as well as loan repayment in case of borrower default.

Loan Purchase Programs

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.

[41] In 2010, the President and Congress enacted a law discontinuing new origination under the FFEL Program. Loans originated under the FFEL Program are now originated under the Direct Loan program, administered by the Department of Education.

In general, there were three types of purchase programs.[42] Under the Participation Interest program, the Secretary of Education purchased a securitized interest in eligible loans at 100 percent of principal and capitalized interest, but lenders continued to service the loans. During the term of this program, lenders had the option to either redeem the participation interests or sell the loans to the government. The government purchased a total of $71.5 billion in participation interests under this program. Eventually, lenders sold the vast majority of the loans ($68.4 billion) in which the government had purchased a participation interest.

The Secretary of Education also established the Purchase Commitment program. It allowed the Secretary to purchase eligible loans (from lenders willing to sell such loans) at 100 percent of principal and accrued interest, plus $75 fee per loan and a one percent origination fee. Approximately $40 billion in loans were purchased under this program, as well as a smaller Short-Term Purchase program.

Straight-A Funding, LLC

Another program established under the authority provided financing to lenders through issuance of commercial paper. Under this program, the government is obligated to buy this commercial paper if investors do not, allowing financial institutions to benefit from the government's participation and lower cost of capital.[43]

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 the commercial paper not sold to investors, while the Secretary of the Treasury (through the Federal Financing Bank) would provide temporary financing. In total, the conduit advanced $41.5 billion in commercial paper to aid about two dozen lenders fund outstanding government-guaranteed student loans.

Impact

The Secretary of Education's actions under the ECASLA authority injected significant liquidity into the market. Financial institutions originated tens of billions 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.

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[42] For further information on the ECASLA programs, visit http://studentaid.ed.gov/sites/default/files/fsawg/datacenter/library/July2011ECASLAReport.pdf.

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

While there was no budgetary cost to taxpayers, the asset purchase programs led to some cases of extraordinary gains when holders of FFEL program loans sold loans to the Secretary of Education. For example, Sallie Mae[44] recorded gains of $284 million in FY2009 and $321 million in Fiscal Year 2010 on these sales.[45]

The Term Asset-Backed Securities Loan Facility

In early 2008, the asset-backed securities (ABS) market began to come 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.

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 TALF-eligible ABS issuances in 2009 and 2010: Sallie Mae and Student Loan Corp. (then a unit of Citigroup).[46]

Impact

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 TALF loans provided for the purchase of federal student loan ABS issuances.

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[44] Occasionally, this report references Sallie Mae, due to the size and scope of its market participation, as well as the limited data availability on other market players. This former government-sponsored enterprise is now fully privatized as the publicly-traded SLM Corp. Since Sallie Mae's businesses are primarily in the student lending sector, public financial statements provide more specific information, compared to other market participants where student lending is a relatively small part of their overall enterprise. Sallie Mae is also a substantial holder of government-guaranteed FFEL program loans, the largest originator of private student loans, and a large government contractor providing servicing and debt collection services on loans owned by the Department of Education. Sallie Mae has also utilized many government-affiliated financing programs, including ECASLA and TALF. These factors, among others, provide useful insight on the overall market.

[45] SLM Corp., 10-K Annual Report for Fiscal Year 2009 (2010) and SLM Corp., 10-K Annual Report for Fiscal Year 2010 (2011).

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

Part Three: Spurring Affordable Loan Repayment Options

While student loans do not pose the same level of systemic risk to the financial system as subprime mortgages may have in 2007, commenters indicated a number of areas where high levels of student debt relative to income may distort economic behavior.[47]

Policymakers have already taken steps to ensure that borrowers of federal student loans can reduce their monthly payments relative to their income to a more affordable level. As the Director of the CFPB and the Secretary of Education note in their *Report on Private Student Loans*, investor demand for asset-backed securities in the years leading up to the financial crisis was a key factor that led to deteriorating underwriting standards on private student loans. Many of the borrowers who took on these loans would graduate in a challenging labor market. While the total amount of outstanding private student loans is much less than the total amount of outstanding federal student loans, high-debt undergraduate borrowers graduating in 2008 disproportionately utilized private student loans when financing their undergraduate education. Of these undergraduate borrowers graduating with $40,000 or more in student loans, 81 percent had private student loans.[48]

Those submitting public comments in response to the CFPB's request for information on this subject put forth a number of potential solutions to make private student loans more affordable.[49] Many referenced additional forgiveness options for specific groups, such as those for members of the military and others employed in public service.[50] The commentary and discussion in this section explores potential affordable repayment options that could apply to all borrowers. It is important to note that the options explored below are not the only options policymakers might pursue to ensure a well-functioning market. Among other initiatives, compliance with existing laws on origination, servicing, and collection of student loans is also critical.

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[47] See, for example, CFPB-2013-0004-7196, CFPB-2013-0004-7215, CFPB-2013-0004-8421, and CFPB-2013-0004-6831.
[48] National Center for Education Statistics, *National Postsecondary Student Aid Study* (2008).
[49] The majority of submissions referenced judicial remedies to unaffordable private student loan obligations. In particular, commenters discussed the unusual treatment of private student loans in bankruptcy proceedings, as well as the use of pre-dispute arbitration clauses found in private student loan contracts. In the *Report on Private Student Loans*, the Director of the CFPB and the Secretary of Education offered analysis on bankruptcy-related issues. They recommended that Congress revisit the 2005 changes made to the bankruptcy code. The CFPB is also conducting a study on the use of pre-dispute arbitration clauses found in consumer financial contracts and will offer analysis upon conclusion of that effort. See http://www.regulations.gov/#!docketDetail;D=CFPB-2012-0017.
[50] See, for example, Comment ID: CFPB-2013-0004-0082 and CFPB-2013-0004-3428.

3.1 Restructuring loans

Many private student loan borrowers wish to repay their loans but need alternative repayment plans when they are unable to earn sufficient income to meet minimum required payments. In 2008, 10 percent of private student loan borrowers devoted more than 25 percent of their income to meet student loan repayment obligations[51] – 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.

Many public submissions to the request for information argued that the terms of private student loans ought to be restructured in order to offer similar repayment options as those available for federal student loans. Some comments described the benefits of allowing borrowers to convert private student loans to federal student loans, so that borrowers can combine debts for the purposes of calculating income-based repayments.[52] Submissions from industry, advocacy organizations, and individual borrowers described how some features of existing loan modification programs in the mortgage market might be applicable in the student loan context.[53]

Current affordable repayment options on federal student loans

Borrowers have a number of options to reduce minimum monthly payment requirements on federal student loans. Many borrowers, particularly those with large debt burdens, are able to extend the amortization period on certain federal student loans from 10 to 25 years. Many borrowers are also eligible for a graduated repayment schedule, where payments start low and increase steadily through the life of the loan. As described earlier, borrowers can also cap their monthly payments on certain federal student loans as a percentage of their income, above a minimum threshold for basic expenses. These options increase the total interest paid over the life of the loan but allow borrowers to reduce their debt payments relative to their incomes.

Borrowers who have defaulted on federal student loans can pursue a rehabilitation option, under which borrowers must make nine out of ten consecutive, on-time monthly payments that are "reasonable and affordable" according to the rehabilitation plan. Upon successful rehabilitation, the Department of Education will request that the default notation from the borrower's credit report be removed.

Current obstacles to offering affordable private student loan repayment options

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[51] Consumer Financial Protection Bureau and Department of Education, *Report on Private Student Loans* (2012).
[52] See, for example, Comment ID: CFPB-2013-0004-7286 and CFPB-2013-0004-7329.
[53] See, for example, Comment ID: CFPB-2013-0004-7207, CFPB-2013-0004-7196, CFPB-2013-0004-8426 and CFPB-2013-0004-0026.

Loan restructuring activity in the private market, where the loan holder offers a concession in order to maximize the expected value of loans, is quite low. While the largest lender in the marketplace has reportedly restructured over $1 billion of loans,[54] the level of activity among the rest of the market is troublingly low. Loan holders may perceive the costs of restructuring to be greater than the potential benefits of doing so.

Many of the largest portfolios of private student loans are held on the balance sheets of complex financial institutions active in many markets.[55] Many of these institutions are addressing a wide range of pre-crisis operational and credit issues, especially in their mortgage businesses, which may dwarf challenges in private student loan portfolios.

Additionally, financial institutions have cited restrictive guidance on accounting guidelines, which prevent some insured depository institutions from offering borrower concessions without conducting a troubled debt restructuring (TDR).[56] This guideline may add complexity for institutions that wish to offer alternative repayment options, especially for institutions without agile information technology, accounting, and servicing platforms.

Finally, there may be structural legal issues which reduce restructuring activity. Some private student loan portfolios held in asset-backed securitization trusts (roughly half of outstanding private student loan debt) may be governed by legal structures that create complexity or pose barriers to flexibility.[57] For example, ABS noteholders may have conflicting incentives based on their seniority in the capital structure. Additionally, servicers may not have sufficient legal ability to make modifications without the consent of noteholders or trust administrators.[58] In addition, the unusual treatment of private student loans in the bankruptcy code might impact the incentive of lenders to renegotiate repayment terms.

Converting private student loans into federal student loans

As noted earlier, many public submissions suggested that distressed private student loan borrowers should be allowed to convert their obligations into federal student loans, in order to take advantage of income-based repayment and other benefits afforded to federal student loan borrowers.[59] Other submissions noted that any program to increase loan restructuring activity should seek to avoid or limit moral hazard on behalf of lenders

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[54] Consumer Financial Protection Bureau, Request for Information Regarding Complaints from Private Education Loan Borrowers, Comment ID: CFPB-2012-0024-0020 (2012).
[55] See, for example, Comment ID: CFPB-2013-0004-6861 and CFPB-2013-0004-7207.
[56] A troubled debt restructuring (TDR) is an accounting standard where the creditor concludes that it has offered a concession to the debtor and that the debtor is experiencing financial difficulty. As of the publication of this report, financial institutions are working with regulators to gather data to assess the appropriateness of the accounting guidance and determine its consumer impact. For further information on TDR accounting, see the Federal Accounting Standards Board's Accounting Standards Update No. 2011-02. See also, for example, Comment ID: CFPB-2013-0004-7207 and CFPB-2013-0004-0927.
[57] See, for example, Comment ID: CFPB-2013-0004-6861.
[58] See, for example, Comment ID: CFPB-2013-0004-8426.
[59] See, for example, Comment ID: CFPB-2013-0004-0135 and CFPB-2013-0004-0819.

and servicers that might have a strong financial incentive to encourage struggling borrowers to convert their private student loans into federal student loans.[60]

Policymakers should be cautioned that outright loan purchases could lead to extraordinary gains by certain lenders and investors who originated very risky loans with lax underwriting standards. For example, some private student lending programs affiliated with for-profit college programs anticipated very high levels of default at origination.[61] Noteholders of the lowest tranches in student loan asset-backed securitization trusts might generate particularly large gains, especially those who may have purchased these notes at significant discount from face value in a distressed sale.

Options for consideration

Some commenters suggest that policymakers may wish to consider developing a program to restructure private student loans in distress[62] or in default from pre-2009 origination cohorts. 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.[63] However, a program facilitated by or in partnership with the government would require significant policy and operational considerations that should not be underestimated. Commenters put forth principles to meet the objective of restructuring private student loans.[64] Below is a discussion of some potential principles if such a program is considered:

(1) Lender concessions and loans restructured with affordable payment terms

Borrowers could seek a restructured loan through a program administrator (a government agency or its representative). Lenders and servicers participating in the program could amend payment terms using a step-by-step approach for offering concessions[65] in order to reach a temporary or permanent target DTI ratio. The lender or servicer would make a number of concessions to reach the target DTI ratio, which might include interest rate reductions, term extensions, principal forbearance,[66] and principal reduction. With a target DTI

[60] See Comment ID: CFPB-2013-0004-7215.
[61] Consumer Financial Protection Bureau and Department of Education, *Report on Private Student Loans* (2012).
[62] By distress, this does not necessarily refer to loans in an official delinquency status. It generally refers to loans where the borrower's required payments, relative to the borrower's income, cause some degree of financial hardship.
[63] We do not provide an estimate of program costs in this document, though we would expect the ratio of restructured loans to public investment using this framework would be quite high. The costs and benefits would be dependent on current market conditions. Should Congress take steps to authorize such a program, agencies with relevant expertise might provide analysis on potential costs and benefits.
[64] See, for example, Comment ID: CFPB-2013-0004-0049 and CFPB-2013-0004-7215.
[65] In the mortgage industry, this is sometimes referred to as a "waterfall" approach.
[66] The principal forbearance tool has been used in the mortgage context, but there is admittedly a different set of considerations in the student loan context, since there is no expected sale of the underlying collateral to retire the remaining principal balance. It may be useful if utilized judiciously. Further analysis could quantify its appropriateness.

ratio, the structure could discourage lenders and servicers from encouraging borrowers to become delinquent in order to qualify for a restructured loan.

(2) Borrower transparency and documentation simplicity

The method of restructuring of loans could rely on a published process, rather than a proprietary formula, so that borrowers better understand which options will be available to them and what their likely payment might be. This method would need to be assessed to ensure that borrowers do not strategically change their behavior to qualify for concessions, though this may be less of a concern if income is the primary determinant.

If the program administrator were to take applications from borrowers and require documentation of income, the program administrator could potentially consider whether the borrower had enrolled in an income-based repayment plan on the borrower's federal student loans. This could streamline the level of documentation needed and enhance borrower understanding of expected payments required on a restructured loan.

Borrowers should clearly understand, for example, whether a loan restructuring would cause servicing to transfer, since such transfers can be a potential source of confusion and harm if improperly executed.

(3) Loss-sharing for defaults proportional to initial level of concession

A program administrator could provide a varying degree of loss-sharing on a restructured loan that defaults,[67] depending on the extent of the lender's concession. For example, term extensions, where loan payments are reduced through lengthening the term of the loan, would not be a significant concession, while principal reduction would be. If the public were to provide funds to spur restructuring activity, it would be imprudent to put public funds at risk for activity the lender or servicer would conduct without indirect financial support from the public.

Should a loss-sharing program be created, further analysis and current market conditions would determine how the loss-sharing would be calculated, as well as whether any initial incentive payment to the lender or servicer would be necessary.[68]

(4) Adequate program compliance

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[67] In the mortgage context, the Federal Deposit Insurance Corporation made use of loss-sharing to scale loan modifications acting as the receiver of the failed financial institution IndyMac.

[68] Some mortgage modification programs have made use of an upfront incentive payment to a servicer. The relatively small balances on private student loans compared to mortgages makes the fixed servicing costs of modifications higher as a percentage of the balance, increasing the necessity of incentive payments. However, the nature of student loan servicing is quite different from mortgage servicing, and many lenders who hold loans they originated also service student loans in house. Lenders who hold credit risk and control servicing may have sufficient incentive to restructure loans without an incentive payment. These dynamics would need to be examined further to determine whether an incentive payment would be a useful tool to efficiently scale the level of restructuring activity.

In order to protect the public's investment and individual borrowers, the program administrator would need to create a compliance function. The CFPB could provide technical expertise on compliance mechanisms to the agency administering the program.[69]

(5) Repair of the borrower's credit profile

Comments from both industry and consumer advocacy groups suggest that it may be useful to allow borrowers who have defaulted to repair their credit profile in a manner similar to the rehabilitation program available for federal student loans.[70] Several commenters noted coding used for the purpose of credit reporting when a federal student loan is rehabilitated or when a loan is being repaid on a modified repayment agreement.[71] The program might also be structured so that the servicer might report the restructured loan as "performing as agreed" when the borrower successfully repays with new loan terms. This might require changes to laws governing credit reporting[72] but could provide additional incentive for borrowers to pay off their restructured loans, which would reduce program costs. It is possible that this might help some young consumers pass employment verification checks and access mortgage credit.[73]

Additional considerations

Public comments from industry participants indicate a number of tax and accounting issues that should be considered.[74] For example, the use of principal reduction may be considered cancellation of debt for tax purposes, and the lender might be required to file a Form 1099-C to both the Internal Revenue Service and the borrower. Some borrowers may meet provisions in the tax code related to "insolvency," limiting the amount of canceled debt included in income under certain circumstances.[75] Other restructured payment terms may not qualify as income from canceled debt. Further study would be necessary to determine whether adjustments to the tax code would be needed.

In addition, accounting guidelines would add complexity when marking previously defaulted loans as performing. The capital vehicle may need to be structured such that the defaulted loan is "sold" in exchange for loss-sharing on a new loan with new terms. In this case, participating financial institutions might recognize a small accounting gain for each loan, since the original defaulted loan would have already been charged off.

[69] The CFPB currently has supervisory and enforcement authority over depository institutions with assets over $10 billion, as well as their service providers and affiliates, for compliance with federal consumer financial laws. The CFPB also proposed a rule to supervise certain non-depository student loan servicers. Comments on the proposal are due by May 28, 2013. The CFPB will carefully consider comments prior to issuing a final rule.
[70] See, for example, Comment ID: CFPB-2013-0004-7187 and CFPB-2013-0004-7200.
[71] See, for example, Comment ID: CFPB-2013-0004-7216.
[72] See Comment ID: CFPB-2013-0004-7187.
[73] See, for example, Comment ID: CFPB-2013-0004-8426.
[74] See, for example, Comment ID: CFPB-2013-0004-0927 and CFPB-2013-0004-7207.
[75] See Internal Revenue Code §108 (a)(1)(B).

3.2 Jumpstarting a refinance market

Today's interest rate environment is very low relative to historic averages. According to the Bureau of Economic Analysis, Americans have reduced the amount of their non-mortgage personal interest payments by nearly $100 billion since 2007.[76] While private student loan borrowers with rates priced as a spread above an index might have seen their rates go down along with market rates, many have been unable to refinance to lower rates to reflect their lower risk of default.[77]

Industry submissions explain that when underwriting private student loans, lenders must account for the probability that borrowers will not graduate or attain gainful employment that will allow them to meet their debt obligations.[78] For variable rate loans, this uncertainty is priced into the interest rate spread charged above an index such as the Prime rate or LIBOR (see Figure 1 below).

Because many young borrowers do not have a lengthy credit history, it is also common to price loans factoring in the credit profile of the co-signer, often a parent.[79] A student loan borrower whose parent has a lower credit score would be subject to a higher price on a student loan.[80]

In submissions to the request for information, commenters noted that borrowers have relatively few refinance options to lower the price of higher rate loans.[81] Industry submissions noted that the risk of borrower distress is lower if the borrower graduates and attains employment.[82] Given these factors and the absence of prepayment penalties[83] on private student loans, a robust refinance market would allow for pricing to more accurately reflect risk.

One industry observer explained:

> *[The] borrower's credit score is not static. If the borrower repays all of his or her debts (not just the student loans) on-time as per the agreement for several years, his or her credit score will improve. Since the credit history of a recent college graduate is often quite short, good behavior can have a disproportionately greater impact on their credit history, leading*

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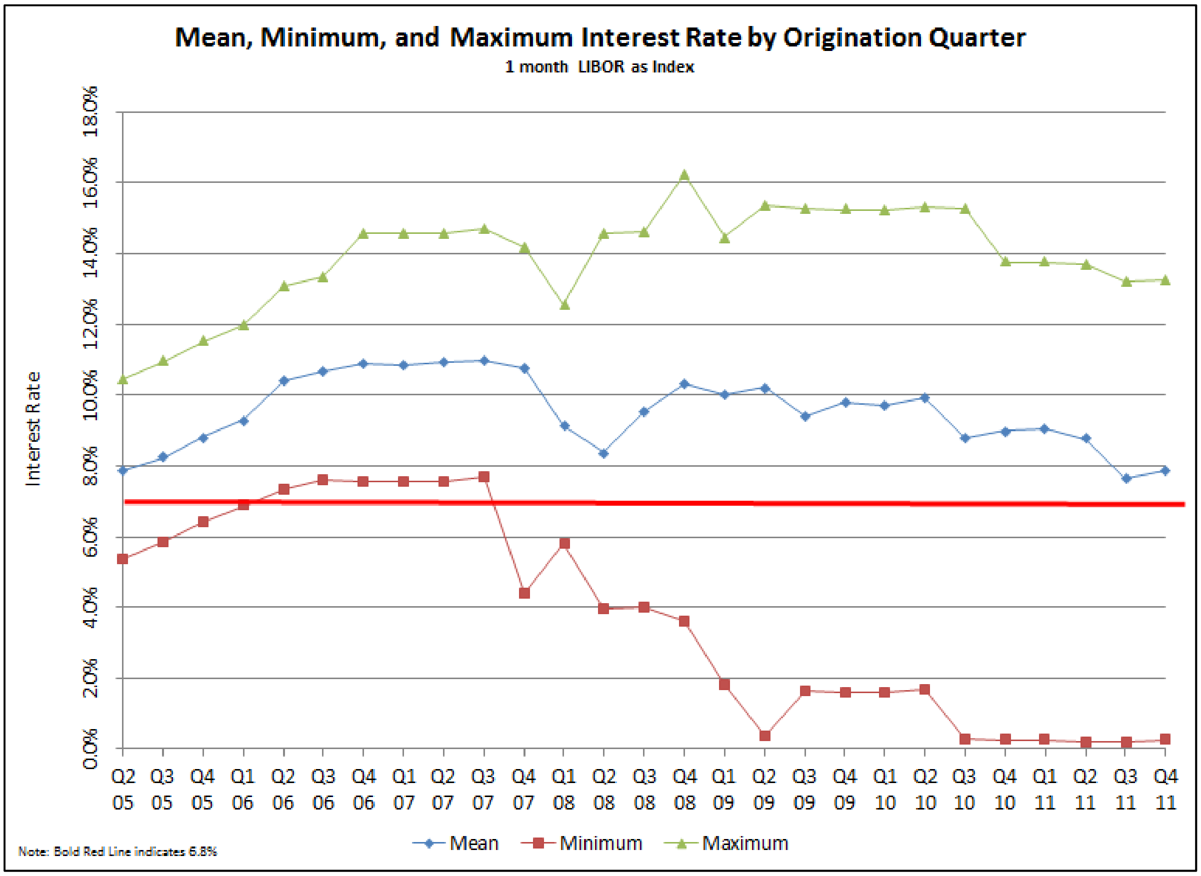
76 Bureau of Economic Analysis, Personal Income and Outlays, Table 2.1 (2013).
77 See, for example, Comment ID: CFPB-2013-0004-0259 and CFPB-2013-0004-7232.
78 See Comment ID: CFPB-2013-0004-7187.
79 See Comment ID: CFPB-2013-0004-6861.
80 Id.
81 See, for example, Comment ID: CFPB-2013-0004-7200.
82 See Comment ID: CFPB-2013-0004-7187.
83 Private student loans generally did not include prepayment penalties, and provisions in the Higher Education Opportunity Act of 2008 amended the Truth-in-Lending Act to codify this practice.

to rapid and significant improvement in the borrower's credit score... So, there should be a thriving marketplace for consolidating private student loans a few years after graduation.[84]

FIGURE 1: PRIVATE STUDENT LOAN INTEREST RATES AT ORIGINATION, 2005-2011



The corollary in the mortgage market would be a homeowner who took out a high rate loan, accumulated substantial equity, and saw significant salary growth. The risk of the loan would then be lower, and it would not be uncommon for the borrower to seek more attractive terms on the mortgage.

Unlike net interest margins (the difference between what a lender earns on loans compared to what it borrows from funding sources) for lenders active in other asset classes, net interest margins in private student lending have not dramatically compressed. These excess credit spreads may be a symptom of insufficient competition.

Current obstacles to increase refinance activity

Commenters note that increased competition by financial institutions to refinance loans for borrowers with high-rate loans who have graduated and become employed could lead to lower prices and monthly

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[84] See Comment ID: CFPB-2013-0004-0050.

payments.[85] But two notable obstacles exist: customer acquisition costs and inadequate access to financing for new market entrants.

The student lending industry generally has relied on marketing loans through the school channel.[86] Marketing refinance products to borrowers who have graduated and are employed was not developed to the same extent,[87] so new market entrants may face high costs to attract potential refinance customers. This problem may be exacerbated by the absence of a database where borrowers can fully understand the complete picture of their student loans.[88]

In the current environment, depository institutions generally have access to affordable capital for lending activities, given low interest rates paid to depositors. However, the limited activity among traditional depository institutions and credit unions in the refinance market is constrained by customer acquisition costs. While activity in this market appear to be growing, it has not yet reached a tipping point where there are online exchanges or other infrastructure for lenders to cheaply find prospective refinance customers.

New market entrants not affiliated with depository institutions can face significant challenges obtaining affordable financing and accessing takeout mechanisms. One industry submission noted that rating agencies are reluctant to rate securities without several years of performance history, making it more difficult to sell pools of loans to insured depository institutions or to other prospective buyers.[89] The submission noted that hedge funds have been willing to purchase refinanced loans, but this is likely a more expensive business model for refinance players, thereby limiting access to refinance products by student loan borrowers with high rates.

Other issues for consideration

Both the Director of the CFPB and the Secretary of Education recommended that Congress seek to provide a way for consumers to see a complete picture of their student loan debt, while protecting borrower privacy.[90] This currently exists for federal student loans in the form of the National Student Loan Data System (NSLDS). Currently, consumers generally can find their student loan obligations on their credit reports, but many reports do not allow consumers to easily discern whether loans are federal or private.

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[85] See, for example, Comment ID: CFPB-2013-0004-7202.
[86] Historically, student lenders marketed FFEL program loans to students and families through the school's financial aid office. Lenders could further leverage the marketing infrastructure of the school channel by offering private student loans. Many schools made use of "preferred lender lists," though the end of the FFEL program and increased restrictions enacted in the Higher Education Opportunity Act of 2008 have reduced usage of these lists.
[87] Many FFEL Program lenders once offered a "consolidation" product to borrowers who left school, though this was a smaller origination platform than the tradition program marketed to students entering school.
[88] Consumer Financial Protection Bureau and Department of Education, *Report on Private Student Loans* (2012).
[89] See Comment ID: CFPB-2013-0004-0051.
[90] Consumer Financial Protection Bureau and Department of Education, *Report on Private Student Loans* (2012).

A centralized source on private student loans could create the conditions and data standards for the emergence of an auction-like marketplace for refinance activity. This could invite participation and competition from a range of potential lenders, including credit unions and other small depository institutions.

To facilitate more refinancing activity of student loans, commenters suggest that policymakers could also consider creating a mechanism to allow providers of refinance products with access to affordable capital,[91] such as a credit facility that provides non-recourse loans secured by qualifying refinanced student loans.[92] If further study determines that lack of access to affordable capital is a major impediment to the development of a refinance market, lawmakers could potentially authorize relevant agencies to facilitate the program, potentially making use of the Federal Financing Bank or other mechanisms to spur refinancing. Terms of the program could be structured such that when the market reaches scale, market participants might find cheaper sources of capital through the private market. The program could be structured to require no net cost to taxpayers, similar to the ECASLA requirement noted earlier.

Comments from industry and advocacy organizations also note other mechanisms to increase refinancing activity, such as awarding credit under the Community Reinvestment Act and encouraging state and local governments to use tax-exempt financing.[93]

Should a robust refinance market develop, conditional prepayment rates on private student loans would increase. Since high levels of prepayment would generally reduce expected returns for a creditor, this could lead to higher prices at origination. However, total interest paid by students who successfully complete degree programs, attain employment, and refinance would likely be less over the life of the loan. Admittedly, students who pursue high-price programs and do not complete these programs could end up paying more if unable to refinance. But borrowers who do refinance might devote interest savings to accelerate more stimulative economic activities, such as first-time home purchases.[94]

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[91] See, for example, Comment ID: CFPB-2013-0004-0051 and CFPB-2013-0004-0050.
[92] It is worth noting that the largest lender in the marketplace has made use of other government-affiliated credit facilities. While Sallie Mae does not originate a noteworthy level of mortgages, it accesses a large line of credit with the Federal Home Loan Bank of Des Moines at favorable terms when pledging certain student loans as collateral.
[93] Comment ID: CFPB-2013-0004-7196.
[94] See, for example, Comment ID: CFPB-2013-0004-0078.

Conclusion

Concerns from financial regulators about the impact of high student debt burdens on macroeconomic conditions are growing.[95] The thousands of comments submitted in response to the CFPB's notice and request for information provide further insight on the impact on individuals. The crisis in the capital markets and the resulting impact on labor markets may have caused significant disruption to the economic opportunities to these borrowers.

With changes in federal student loan terms set to take effect, policymakers may be tempted to focus efforts on future generations of federal student loan borrowers. But the comments from the public should serve as an important reminder that many borrowers are still stymied by private student loan debt and have no good options when they seek ways to make their payments more affordable.

The comments also provide a broad range of ideas and insights that policymakers can consider as they seek to correct problems in this marketplace. Policymakers employed a variety of creative solutions to facilitate lending activities by financial institutions during the height of the crisis. The comments received on the problems in today's marketplace, combined with the lessons learned from efforts to solve market-wide issues in the recent past, should help policymakers as they consider the best ways to facilitate the viability and economic participation of consumers facing heavy student debt burdens.

[95] See footnote 6.

4. Contact Information

TO REACH THE CFPB'S STUDENT LOAN OMBUDSMAN:

Email:	students@cfpb.gov
Webpage:	http://www.consumerfinance.gov/students
Address:	Consumer Financial Protection Bureau 1700 G St NW Washington, DC 20552

TO FILE A COMPLAINT:

Webpage:	http://www.consumerfinance.gov/complaint
Toll-Free:	(855) 411-CFPB (2372)
Español :	(855) 411-CFPB (2372)
TTY/TDD:	(855) 729-CFPB (2372)
Fax:	(855) 237-2392
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