Consumer Financial Protection Bureau

May 8, 2013

CONSUMER FINANCIAL PROTECTION BUREAU REPORT HIGHLIGHTS HOW CHALLENGING STUDENT DEBT BURDENS CAN BE A ROADBLOCK TO OPPORTUNITY

The Consumer Financial Protection Bureau (CFPB) published a report summarizing input from the public about ways in which student loan debt can be a roadblock to a full financial life for consumers. The report identifies options for policymakers and market participants to consider in order to help borrowers manage their private student loan debt.

Student Loan Debt by the Numbers

- **$1.1 trillion:** Approximate amount of outstanding student loan debt—second only to mortgages in household debt.
- **1-in-5:** U.S. households that have student loans.
- **$26,682:** Average outstanding balance for a borrower with student debt.
- **1-in-8:** Share of borrowers with more than $50,000 in student debt.
- **40 percent:** Share of American households headed by someone under 35 that have student loan debt.
- **25 percent**: Share of borrowers under age 30 that spend more than 10 percent of their income on student loan payments.
- **30 percent**: Share of borrowers in repayment that are delinquent on a student loan.
- **6.7 million:** Number of borrowers who are more than 90 days delinquent on a student loan.
- **31 percent:** Percentage increase in the number of student loan borrowers between 2007 and 2012.

Overview

College graduates earn more and have lower unemployment rates, compared to those without a degree. A college education can be the key to a better life. But the cost of college has risen consistently in the past several decades. To help pay, more Americans have turned to both federal and private student loans. The vast majority of high-debt borrowers have private student loans. In 2008, more than 80 percent of college graduates with at least $40,000 in student debt had private student loans.

Private student loans are generally riskier for borrowers than federal loans—their interest rates are higher, and they have fewer consumer protections. Most notably, they often lack flexible repayment options when borrowers are unable to earn an income sufficient to cover minimum payments—a situation faced by many recent graduates who faced a tough economy in the years just after the financial crisis.

The CFPB is committed to finding ways for students to manage their debt. Over the past decade, when adjusting for inflation, wages for college graduates have fallen by 5.4 percent even as total borrowing has climbed 49 percent. In February 2013, the CFPB published a Notice and Request for Information soliciting input on affordable repayment options for borrowers with existing private student loans. In response, the CFPB received over 28,000 comments.

The Dodd-Frank Wall Street Reform and Consumer Protection Act established an ombudsman for student loans within the CFPB. The ombudsman is charged with providing analysis and reports to the CFPB Director, the Secretary of Education, the Secretary of the Treasury, and other policymakers. Today's report provides an analysis of the comments received, assesses recent actions of policymakers in the private student loan market, and includes commentary and discussion on policy options put forth by the public.

Student Debt Domino Effect

Those who submitted comments to the CFPB were concerned about the potential domino effect of student loan debt on the economy. Many comments described how monthly student loan payments can deplete consumers' personal savings, may crowd out other types of consumer spending, and may shape the choices young graduates make about their careers and the communities in which they live. Other federal monitors of the financial system have also raised concerns about the impact of student debt on the broader economy, particularly the effect on household spending and demand for mortgage credit. The Financial Stability Oversight Council, the Department of the Treasury's Office of Financial Research, and the Federal Reserve System's Federal Open Market Committee have all referenced the potential impact of student debt.

- **Housing:** The current generation of first-time homebuyers might be inhibited by a heavy student debt burden that may hurt their ability to qualify for a mortgage or to save for a down payment. First-time homebuyers play a critical role in the market by increasing demand and allowing existing homeowners to "move up" or purchase their next home.

  - **The share of young consumers among first-time homebuyers is falling.** According to the National Association of Realtors, Americans between the ages of 25 and 34 made up 27 percent of all homebuyers in 2011, the lowest share in the past decade. That percentage represents a 25 percent decline year-over-year from 2010.

  - **Young borrowers with student debt are less likely to own a home than those with no debt.** According to recent analysis by the Federal Reserve Bank of New York, young borrowers with student debt—historically an indicator of a college education and an accompanying boost in wages—demonstrate a lower rate of homeownership than their peers with no student debt, breaking a decade-long trend.

  - *Comment:* "I've been left with a large amount of private debt…I've always strived to pay off bills on time. My monthly loan payment though, of almost $600, meant that my wife and I waited several years longer to buy a house." – Josh

- **Small Business Development:** Student debt can limit consumers' ability to access small business credit and to save capital. If consumers are able to save enough to start small businesses, student debt burdens may require them to divert cash away from their businesses so they can keep up with their student loans.

  - **Strong personal credit history is a prerequisite for small business financing.** Many lenders include personal credit history among the evaluation criteria for a new small business loan. Financing contingent on strong credit puts new graduates with high student debt at a disadvantage—and may prove to be a barrier to entry for aspiring entrepreneurs. Those with student debt may have lower credit scores if they have struggled to make their monthly payments.

  - **The recession has battered credit scores of young consumers and student debt is playing a role.** According to the Federal Reserve Board of Governors, since the recession, the share of young graduates' outstanding credit consumed by student loans has jumped by 14 percent. According to recent research by the Federal Reserve Bank of New York, young student loan borrowers now have lower credit scores than their peers with no student debt. Both facts make it more difficult for borrowers to qualify for small business loans.

- **Lower monthly student loan payments can help young entrepreneurs get small business credit.** The Small Business Administration's Startup America initiative advises young entrepreneurs to lower their student loan payments by taking advantage of an income-driven repayment program for their federal student loans. Most private student loan borrowers do not have this option. They may find it impossible to access credit or to make ends meet when founding a new venture.

- *Comment:* "Student debt has [pushed off] my goal to open a small business by not allowing me to save enough money or even qualifying for a business loan to initiate the business." – Columba

- **Retirement Savings:** Those with student debt may be unable to save for retirement or may have to rely on their parents, who are nearing retirement, to help pay their debt.

  - **Young consumers may be failing to adequately save for retirement***.* Recent research revealed that only half of workers under 30 have enrolled in their employer's 401(k) plan. Another study found that barely four-in-ten contribute enough to receive a full employer match.

  - **Older consumers have taken on record levels of student debt.** The share of these families with debt has increased by more than 55 percent and average balance has more than tripled, when compared to a generation earlier. According to AARP, in 2010, more than ten percent of families ages 50-64 had student debt with an average balance of $28,090.

  - *Comment:* "As an older student, I will likely retire before I finish paying off my student loans. We've been trying to pay down the student loan debt as much as we can while I'm still on in-school deferment, but as a result are putting away less toward retirement, which will really hurt later." – Jeanne

- **Rural Communities:** Rural areas often struggle to attract and retain young professionals. Car ownership may be a prerequisite for employment and rental housing may be scarce. For cash-strapped student borrowers, the need to buy a car or a house may deter them from moving to a rural area. In particular, it may be difficult to attract health care professionals and educators.

  - **Many teachers in rural areas earn less than their peers.** According to the National Postsecondary Student Aid Survey, three-quarters of new teachers with master's degrees teachers carry an average of more than $35,000 in student debt. Teachers in rural districts generally earn less than their peers—but carry the same amount of debt. Lower salaries can deter teachers with debt from working in rural areas.

  - **Younger consumers with student debt may own vehicles at lower rates than their peers—an impediment to employment in many rural communities.** According to CNW Market research, the share of new vehicles purchased by Americans ages 21-34 has dropped 10 percent since the pre-recession peak— this represents the smallest share in over a decade. According to the Federal Reserve Bank of New York, young borrowers with student debt—historically an indicator of a higher education and better wages—are no longer more likely to have a car loan than their peers without student debt, breaking a decade-long trend.

  - **Many rural communities face shortages of primary care providers and student debt has been shown to drive medical school students away from primary care.** Population growth and aging will drive the demand for increased primary care and recent estimates suggest that the U.S. will need as many as [52,000 additional primary care physicians](#) by 2025. The [American Medical Association](#) wrote that high debt burdens can impact medical students' choice of specialty, exacerbating the primary care shortage.

- *Comment:* "I live in rural Oklahoma, to get to work...you have to have a car… I am aggressively trying to pay off [my private loans] so I can qualify for a house. My debt to income is too high at this point." – Bridget

Policy and Market-Based Solutions

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. The CFPB sought ideas to help borrowers with their private student loan debt. Today's report offers commentary on solutions submitted in response to the Request for Information. The options discussed 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.

- **"Refi relief" for borrowers who pay on time:** Comments from market participants, policy experts, and individual borrowers suggest that refinance options could offer relief for responsible borrowers. These borrowers have high-rate loans but have dutifully made their payments on time and, as a result, their credit has improved since they first borrowed. Interest rates on private student loans are often based on perceived risk. But when borrowers graduate and find a job, they may be unable to find a refinance option with a lower rate that reflects the strong likelihood they will fully be able to pay back their loan. Commenters suggested that policymakers can play a role to jumpstart a refinance market. If borrowers are eligible to refinance their debt at lower interest rates, they could potentially save thousands of dollars in the process.

  - **Prior to the financial crisis, borrowers had more options.** Before the financial crisis, there were more lenders offering products to allow borrowers to refinance student loans. Much like other sectors of the financial services marketplace, the credit market dried up and consumers had more difficulty accessing these products.

  - **Many borrowers believed better products would become available.** Some commenters reported that they borrowed high-rate private student loans before the financial crisis, believing lower-rate products would be available down the road. But after graduation, many borrowers found out that the landscape had shifted, and this door had closed.

- **A "road to recovery" for borrowers in distress:** Other comments suggest that a "road to recovery" could be a solution for struggling borrowers trapped in the terms of their private student loans. In October 2012, the CFPB published a report which highlighted consumer complaints where lenders and servicers were purportedly unwilling to negotiate affordable loan terms. The "road to recovery" offered by the lender could be a negotiable, transparent, step-by-step process where monthly payments are lowered to match a reasonable debt-to-income ratio.

  - **Graduates faced tough employment market.** After graduating into the worst labor market in decades, many borrowers have experienced long periods of unemployment or underemployment during which they were unable to keep up with their private student loans. After falling behind, consumers report escalating balances, higher monthly payments and few options to get back on track.

- **The recession had a lasting impact on borrowers' financial lives.** For these borrowers, a good job and an improving economy may not be enough to undo the damage caused by the recession. Comments suggested that borrowers need an easy way to negotiate an affordable repayment plan with their lender through a transparent, streamlined process.

- **A "credit clean slate" for borrowers in default:** A number of comments propose that a "credit clean slate" option would be appropriate for borrowers who need a way to repair their credit and get out of default. The borrower works with the lender to come up with a payment plan to help the borrower get out of default. When the borrower adheres to the payment plan, this might help the borrower get back on his or her feet, pass employment verification checks, and head down the road to owning a home or starting a small business.

  - **Federal student loans have more options than private student loans.** When borrowers hit a rough patch with their federal student loans, they generally can take advantage of programs to avoid default and protect their credit history. But borrowers generally do not have these options on private student loans.

  - **Private student loan borrowers could benefit from loan rehabilitation programs.** Commenters suggested that policymakers look at the federal student loan rehabilitation program that removes the loan default notation from a borrower's credit report if the borrower participates in a defined payment plan with the Department of Education.