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Hearing on "Increasing Student Aid through Loan Reform"

Good morning Chairman Miller, Ranking Member McKeon and Members of the Committee. My name is Jack Remondi. I am the Vice Chairman and Chief Financial Officer of Sallie Mae. I am here on behalf of Sallie Mae's 8,000 employees, 1 million college savings plan customers and 10 million student loan customers, and I thank you for the opportunity to testify on federal student loan reform and the opportunities it provides for increasing student aid.

The student loan reform proposal in the President's FY 2010 budget outline continues an important discussion about improving access to postsecondary education, and as a saving-, planning- and paying-for-college company with a 37-year history of helping make higher education accessible and affordable for America's students, Sallie Mae is grateful for this opportunity to add our voice to the discussion.

Overview

First, I'd like to take a moment to introduce you to Sallie Mae. Since our creation in 1972, we have helped more than 21 million Americans pay for college. Through our Upromise affiliates, the company manages more than $17 billion in 529 college-savings plans for more than 1 million families, and is a major, private source of college funding contributions in America with 10 million members and more than $475 million in member rewards.

Sallie Mae is a shareholder-owned, for-profit business. We are proud to employ more than 8,000 workers in 17 states. As a participant in the Federal Family Education Loan Program (FFELP), Sallie Mae has raised billions in private sector capital to lend to students and parents to help them meet the cost of college. In the last decade alone, Sallie Mae has provided approximately $120 billion in federal student loans to students and parents.

At the outset, I want to underscore significant areas of agreement between Sallie Mae and the Administration. Sallie Mae fully supports the Administration's objectives of assuring stable funding of the federal student loan program while generating tens of billions of dollars in taxpayer savings that can be used to increase need-based grant aid for students, specifically to put the Pell Grant program on stable footing. Sallie Mae also supports the objective of achieving the most efficient and effective student lending infrastructure, which should preserve an important role for private student loan originators, including smaller, regional, state and non-profit providers.

Within this context, Sallie Mae proposes improvements to the Administration's outline that would meet these objectives, and do so in a manner that eliminates transition or implementation risk, and preserves beneficial competition in the delivery of service to schools and students.

Our objective is straightforward: construct a responsive, evolving student loan program that best meets the needs of students and schools, while delivering the best value to taxpayers. We propose using a competitive student loan delivery infrastructure to originate, service and collect student loans on behalf of the government, on a fee-for-service basis, using low-cost federal funding direct from the United States Treasury.

We believe that the best program for the long term is one that allows consumer choice and competition to drive efficiency, innovation and improvement.

The Administration's proposal acknowledges the benefits of competition by reserving a role for competitively bid loan *servicing* and collections. Retaining these positive forces in the loan *origination* process as well will ensure that the individual needs of students and schools will continue to be met in the new program. By combining choice, competition and innovation with low-cost and stable direct government funding, we will have a system that serves the needs of students, schools, taxpayers, and the 35,000 people who work directly for student loan providers - all without risk of transition problems or unnecessary additional school expenditure.

And we do know for a fact that such a program would work, because it did this year.

Sallie Mae's ability to meet the growing demand for federal student loans today is due to the programs established by the Ensuring Continued Access to Student Loans Act (ECASLA). ECASLA, which is the direct result of the leadership and hard work of this Committee, authorized the programs that allow every student at every school to have access to student loans this year and next. In fact, unlike virtually every other consumer loan market, with or without government support, every eligible student or parent who sought a federal student loan got one. This is an amazing statistic in this economic climate. Sallie Mae is very proud of the role it played in making this happen.

The temporary ECASLA programs have done more than see students through this uncertain time; they have demonstrated a way forward.

The Administration's proposal and the ECASLA programs share the savings-generating component of federal ownership of student loan assets. The major difference is the process and timing of how and when the government owns the asset. Under ECASLA, lenders originate the loans and decide whether or not to sell them to the government. Under the Administration's proposal, the loans are

originated by the government and owned by the government. Our suggested modification to the Administration's proposal authorizes lenders to originate the loans *for* the government, with government capital, on a fee-for-service basis – ending lender subsidies altogether.

Under this construct, as in the Administration's, the government, not the lender, enjoys the economic benefit of loan ownership from the beginning, so lender subsidies are eliminated. Under this construct, as under ECASLA, schools and students remain free to choose the loan origination process and service provider that works best for them.

The Administration's proposal, once a detailed version of it is officially evaluated by the Congressional Budget Office (CBO), will likely generate tens of billions of dollars in budget savings that can be used to pay for increasing Pell Grants. We agree that major budget savings should be a feature of loan reform. Modifying the Administration's proposal as we suggest will likewise generate tens of billions of dollars of budget savings for Pell Grants, in addition to other benefits that may not be fully captured within the budget-scoring model.

The Administration's proposal would end the politically set lender subsidy rates that have been the cause of so much contention. We support that outcome completely, and elimination of lender subsidies is a feature of the Administration's plan we would leave unchanged.

The Administration's proposal guarantees that loan capital always will be available and insulated from volatile capital markets. We, too, support a structure that achieves that result.

We enthusiastically support creation of a program that generates savings by capitalizing on low-cost federal funding – the heart of the Administration's proposal – and that offers students and schools the ability to choose the loan origination platform and processes that best meets their needs, fosters competition

and shares risk to enhance the level of service, lowers costs for taxpayers and preserves 35,000 existing private sector jobs in the student loan industry.

Specific Enhancements and the Resulting Benefits

By utilizing federal funding, establishing common loan terms, and replacing a subsidy model with a fee-for-service model, the President's proposal builds a solid foundation for a new federal student loan program. We respectfully submit, however, that it could and should be made better to ensure it is even more accountable to students, schools and taxpayers. Specifically, we recommend the following key enhancements to the Administration's student lending reform proposal:

- Allow schools to choose the loan delivery platform and loan originator that works best for them, including the Department of Education's Direct Lending infrastructure;
- Introduce a new risk-sharing program that requires all student loan servicers to have "skin in the game" so loan defaults are minimized;
- Allow originating lenders the opportunity to retain servicing if they meet the Department's basic criteria (e.g., price, quality, financial controls, compliance, etc.), with no minimum thresholds for servicer size;
- Permit schools choosing the Direct Lending originations process, or those choosing private lenders who do not provide servicing, to choose a loan servicer from among the Department's servicing contractors;
- Require the Department to set origination fees via market mechanisms designed to preserve broad participation of originating lenders, including smaller, regional, state and non-profit lenders; and

- Require the Department to set parameters for other school-based and borrower-based default prevention initiatives – such as financial literacy programs and borrower counseling.

Avoidance of Implementation Risk

The Administration's proposal would require all schools to originate loans through a single, Department of Education-run platform. This would require more than 4,000 schools to convert from the platform of their choice.

Moving to a Direct Lending-only delivery system would quadruple the volume of loans delivered by the federal government within one year, and rely on one delivery "pipe" for some 6,000 schools and $90 billion in loans annually.

In contemplating such a drastic increase in volume, one should consider that in 2008, in the midst of unprecedented fears over the credit crisis, only about 400 schools converted to the Direct Lending delivery platform and actually made loans through the Direct Lending system. A wholesale move to the Direct Lending platform by July 1, 2010 would mean converting more than *10 times* as many schools to the Direct Lending origination system than have ever converted in a single year. In fact, the July 1, 2010 date is misleading as most schools must start processing loans as early as February 2010, less than 9 months from now.

By maintaining a competitive delivery network, such as the one that currently serves 75 percent of colleges and universities, the risks associated with requiring thousands of schools to switch to the Direct Lending origination platform – potentially disrupted student access to loans and the consequent lost savings for Pell Grants – are removed completely.

Preservation of Choice for Students

Two years ago, Congress passed legislation requiring that schools participating in FFELP include at least three lenders on a preferred lender list. This requirement guarantees that borrowers have a choice of lender during the loan process, to say nothing of the fact that then and now borrowers have been free to choose any qualified lender, including their hometown bank or credit union. We know that competition and choice are good for consumers. Great products and services come from entities that have great competition. When customers can be lost through competition, the pressure to innovate and improve products and services is unrelenting.

Competition from Direct Lending forced private lenders to invest in and improve their loan delivery systems. Undoubtedly, competition from private lenders forced Direct Lending to invest in its loan delivery system. Mandating that every student at every school must use a single loan originator, irrespective of suitability, will eliminate any incentives for future investments in a loan delivery system. Monopolies, even governmental ones, are antithetical to high-quality service and innovation. Absent competition and investment in loan origination systems, it is unlikely that what works for students today will continue to work for them tomorrow.

Preservation of Choice for Schools

Since the inception of Direct Lending in 1993, schools have been free to convert to the Direct Lending program, and indeed many schools have. After peaking at 34 percent of volume in academic year 1998-99, the Direct Lending program now serves about 25 percent of colleges and universities. However, the fact that the Direct Lending origination platform works for some schools does not mean it will work for all of them. Schools utilizing the Direct Lending program tend to be larger schools, which are more comfortable dealing directly with a

federal department and more adept at performing the required functions, such as reconciliation of funds and promissory note collection.

To illustrate this point, I note that 30 percent of public, 4-year colleges are in the Direct Lending program. Only 10 percent of community colleges, which have smaller student bodies, lower tuition, and smaller staffs, are in the Direct Lending program today. Requiring all schools to use the Direct Lending origination platform may pose significant and ongoing burdens on schools least able to absorb additional implementation, programming and staffing costs. With the changes to the Administration's plan that we propose, no school would be *required* to convert to the Direct Lending delivery system, but every school would retain the freedom they have today to convert if they choose.

No Additional Costs to Schools

By not requiring all schools to convert to Direct Lending, our proposal would save staff time and expense – sometimes ranging into the hundreds of thousands of dollars – that might otherwise be passed on to students or state taxpayers.

Risk Sharing in Loan Servicing

We believe that it is in everyone's interest to require all servicers to have "skin in the game" by sharing in the performance of every loan. Loans originated and serviced by Sallie Mae have a roughly 30 percent lower cohort default rate by school type compared with the Direct Lending Program. In fact, if Sallie Mae had been servicing the Direct Lending portfolio for borrowers entering repayment in 2005 and 2006, we estimate that we could have helped 15,000 borrowers avoid the consequences of default, and saved taxpayers $200 million in avoided defaults.

We attribute this superior performance to the fact that Sallie Mae has "skin the game" in the form of fees and costs we incur to originate loans and a three percent risk-sharing component that provides a strong incentive to reduce defaults. Direct Loans are serviced on a pure fee-for-service basis. To maintain the incentives that have driven superior default prevention results by Sallie Mae, we propose adding a three percent risk sharing arrangement to the servicing structure to create the incentives for all servicers to help borrowers avoid default and save taxpayer dollars. If this modification reduces defaults by only 10 percent, hundreds of thousands of students would avoid the increased fees, damaged credit, and obstacles to obtaining other credit, housing, and professional advancement that result from a default, while saving taxpayers billions of dollars.

Value-Added Services in Private Sector Loan Delivery

Loan originators add significant value to students and schools beyond the delivery of funds. It is important to preserve the role they play at 75 percent of the nation's colleges and universities. In evaluating any one benefit or service, it is important to remember that from the student's perspective, the act of paying for college is not a series of steps that begins with "origination" and ends with "servicing." For the student, the process begins with planning and saving for college, continues with debt counseling, applying for a loan, receiving the funds, graduating, managing the debt and paying the money back.

Student lenders bring expertise, insight and understanding to that entire borrowing lifecycle and know how to present the right information and options at the right time.

The upcoming launch of Income Based Repayment (IBR) illustrates this concept. IBR is a welcome, new, borrower-friendly repayment option Congress

provided to student borrowers starting July 1 of this year. IBR will help lower-income borrowers lower their monthly payments to a manageable portion of their income.

This new benefit might be considered a "servicing" issue because it is technically a repayment option, but that would be a mistake. For students to benefit from this new tool, work needs to be done. Schools need to counsel their current students on this option before they leave campus. Future students need to learn about this option and what it means to them, and they need to have this information with them at application, during origination, and before going into repayment.

Sallie Mae began holding workshops and in-person school visits to discuss IBR in January – six months before it becomes available. Sallie Mae has been asked by several Direct Lending schools to provide these same briefings on how students can get the most of a new benefit, an example of how competition leads directly to enhanced services.

Starting in March, Sallie Mae began to identify students who are likely to benefit from the new program and started educating those individuals about it with targeted counseling. Sallie Mae has posted information and worksheets and employed an interactive presentation on our website to educate borrowers (www.salliemae.com/ibr). We have built, and will launch in early June, a robust payment calculator that allows borrowers to model whether IBR makes sense for them. In a non-competitive environment, these value-added services would exist only if specifically called for by contract terms.

In these economic times, it is more important than ever that the borrower benefits Congress builds into the federal student loan programs reach each eligible student. Student loan providers have the expertise, ability, and incentives to make that happen.

Other Examples of Loan Provider "Value-Added" Services

School-Specific Services: Private sector loan originators tailor loan delivery systems and support services to meet the needs of every school type, regardless of IT systems, staffing levels, special requirements or sophistication.

The real world of school financial aid is an often hectic environment with a seasonal crush of work at the beginning of the semester, serving students and families that are increasingly stressed by the weak economy. School financial aid offices range from one or two professionals to many dozens, and information systems range from name brand "enterprise" systems to those that are "home grown."

In delivering loans to 75 percent of schools, competitive private sector loan providers have adapted to the needs of many different types of schools, with many different types of administrative systems to get the job done. The result is that schools are better able to manage the seasonal crush of volume and students and families have the opportunity to get high-quality service, regardless of the institution they attend.

In addition to providing customized technology interfaces, private sector loan providers also offer schools extensive technical and program policy support. For example, Sallie Mae's dedicated school loan delivery services team provides comprehensive technical and process training to institutions and responds to approximately 750,000 school questions and requests for support every year at more than 4,000 institutions.

In contrast, a single origination platform would be a "one size fits all" approach. This may work for some schools, but it is not tested to address the

tremendous diversity of administrative and technology environments and support needs represented by the school community as a whole.

Front End Default Prevention Programs: Many loan originators and guarantors provide end-to-end debt management and default reduction programs that begin with education *before* students take out their first loan, and continue through successful repayment. Today, guarantee agencies also provide a variety of debt education and debt management programs, which further strengthens the quality of outreach at the "front end" of the lending process.

Other Value-Added Programs and Services: Because they compete for business, private sector lenders, secondary markets and guaranty agencies are incented to provide a variety of "value added" programs and services that directly support the needs of students and families, and strengthen the ability of schools to serve students and families. These initiatives are particularly valuable to schools and families with limited resources. Examples include:

- Financial literacy programs and tools (e.g., paying for college calculators, paying for college seminars, information on maintaining good credit). Sallie Mae's Education Investment Planner is a recent example of this. The Education Investment Planner is a free tool for students and families to show them that with planning, knowledge, and smart decisions, a college education is within their reach. It also provides families with the information they need to make knowledgeable decisions about which school is right for them. The Planner is available at www.salliemae.com/content/landing/planner/eip.

- Access programs (e.g., scholarship search tools, customized outreach programs – about college planning and funding – for Hispanic/Latino and African American students and families); and
- Tools to help schools counsel borrowers on changing regulations and repayment options.

Innovation: Competition among loan providers and between the FFEL and the Direct Lending programs has made each program better over the years. Competition has driven investment and innovation in more automated and streamlined disbursement processes, and in web sites, brochures, and other materials that explain the myriad of financial aid options to students and families.

Competition creates a culture of accountability for customer satisfaction. Removing incentives to innovation and accountability for customer satisfaction will result in a complex, nearly $100 billion per year lending program that will be left with just one model, prescribed completely by government specifications, with no choice for schools or borrowers to "vote with their feet" if their needs are not being met.

Preservation of Jobs

In passing the budget resolution last month, this Congress clearly expressed a preference for moving forward in a way that minimizes job losses in this difficult economic time. It is worth reiterating that most of the savings of the Administration's proposal and the structure we recommend are driven by government ownership of student loan assets, not from the intentional elimination of good private sector jobs.

Further, we believe that the job-preserving policy option, in which the existing structure is utilized, is the more promising, more efficient, less risky course of action, even if concern for jobs is taken out of the equation.

Additional Benefits to Taxpayers (and Financial Aid Recipients)

I want to highlight that some additional benefits of the structure we are proposing may or may not be captured by the Congressional Budget Office's assumptions. Nonetheless, these benefits will bring value to the taxpayer and possibly generate additional resources for student aid. They are:

- **Savings from Lower Defaults:** The value of the lower defaults we expect to generate by introducing the risk-sharing component is substantial. Even assuming a modest reduction of 10 percent from current default rates (e.g., 13.5 percent vs. 15 percent lifetime default rate), taxpayers would collect on more than $1 billion per year in loans that would have otherwise defaulted.

- **Savings from Immediate Implementation:** Much of the savings assumed by CBO occur in the first years of implementation. This means that any delay in the conversion of more than 4,000 schools to the Direct Lending program would have severe consequences to the estimated savings of the Administration's proposal. By using the existing FFEL loan delivery infrastructure, there is no risk of a delay in program implementation, and the savings are realized immediately.

- **Savings from Competitive Fee Setting:** We recommend that after two years of operating the new program with a set fee, a market-based process be used to drive further efficiencies into the program, saving taxpayers yet more.

Conclusion

In conclusion, Sallie Mae supports the Administration's objectives of reforming the federal student loan programs and increasing funding for Pell Grants. We are not trying to preserve lender subsidies, nor are we trying to preserve the FFEL program as we know it. We are offering recommendations that build from the foundation of the President's proposal, to make that proposal even better, and to guarantee that it seamlessly delivers the shared objectives of the Administration, this Committee, and America's students and families.

Thank you. I would be pleased to answer any questions you may have.