

**Testimony before the
U.S. Senate Banking Subcommittee on Financial Institutions and Consumer Protection**

“Private Student Loans: Providing Flexibility and Opportunity to Borrowers?”

July 24, 2012

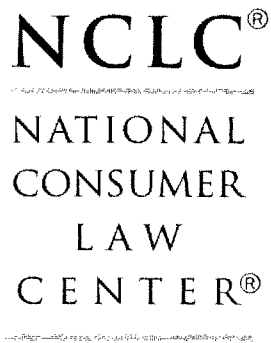
Testimony submitted by:

Deanne Loonin

Attorney

National Consumer Law Center (NCLC) and

Director of NCLC’s Student Loan Borrower Assistance Project



7 Winthrop Square, 4th Floor

Boston, MA 02110

(617) 542-8010

www.consumerlaw.org

**Testimony of Deanne Loonin for the
U.S. Senate Banking Subcommittee on Financial Institutions and Consumer Protection**

“Private Student Loans: Providing Flexibility and Opportunity to Borrowers?”

July 24, 2012

The National Consumer Law Center (NCLC) thanks the Committee for holding this hearing and inviting us to submit this testimony on behalf of our low-income clients. The National Consumer Law Center is a nonprofit organization specializing in consumer issues on behalf of low-income people. We work with thousands of legal services, government and private attorneys, as well as community groups and organizations that represent low-income and older individuals on consumer issues.¹ NCLC’s Student Loan Borrower Assistance Project provides information about student loan rights and responsibilities for borrowers and advocates. We also seek to increase public understanding of student lending issues and to identify policy solutions to promote access to education, lessen student debt burdens and make loan repayment more manageable.²

In my work as the Director of NCLC’s Student Loan Borrower Assistance Project, I provide training and technical assistance to attorneys and advocates across the country representing low-income student loan borrowers. I have written numerous reports on student loan issues and am also the principal author of NCLC’s *Student Loan Law* practice treatise.

I provide direct representation to low-income borrowers through Massachusetts-based legal services and work force development organizations. I also have daily contact with a wide range of borrowers through our student loan web site. Because of my extensive experience representing student loan borrowers and working on student loan matters, I have served as the legal aid representative at a number of Department of Education negotiated rulemaking meetings, including the “Loans team” session earlier this year. My testimony is based on this work and previous work representing low-income consumers at Bet Tzedek Legal Services in Los Angeles.

Introduction

Predatory private student lending has shattered the dreams of many individuals seeking to better their lives through education. These loans became a curse, not an opportunity, for all too many borrowers. Those harmed by lender predatory practices are now stuck trying to get those same lenders to provide relief.

¹ In addition, NCLC publishes and annually supplements practice treatises which describe the law currently applicable to all types of consumer transactions, including *Student Loan Law* (4th ed. 2010 and Supp.).

² See the Project’s web site at <http://www.studentloanborrowerassistance.org>.

This is a critical time for policymakers. Student borrowers who were harmed by irresponsible private student lenders need relief and steps must be taken to ensure that the private student loan market that emerges from the credit crisis is fair and efficient. The last thing students need is a new race to the bottom in the guise of a “recovered” predatory private student loan market.

My testimony highlights the following problems in the private student loan market:

- Due to the lack of a meaningful bankruptcy option or any federally mandated relief, students with little experience in financial matters can incur tens and even hundreds of thousands of dollars of completely unaffordable debt that will follow them and damage their credit for their entire lives.
- Too many students take out private students without having exhausted cheaper and safer federal financial aid.
- Some for-profit schools are making predatory institutional loans that they know, at the outset, students cannot repay.
- Private student loans have high default rates that are likely to climb.
- Most private student lenders have failed to adopt any meaningful policies, such as long-term repayment options or loan modifications, to help students who are buried in debt.
- Despite receiving disclosures, co-signers often do not realize they are liable for loans and lenders often refuse to cancel loans even in the event of the student’s death.
- Little data is available on the private student loan market and is sorely needed.

I discuss a number of recommendations for reform throughout my testimony, including a summary of key recommendations at the end.

The Rise, Fall and Rise Again(?) of the Private Student Loan Market

The student loan market is unique in that the government is the primary supplier of loans through the federal student loan program. According to estimates from the Consumer Financial Protection Bureau (CFPB), outstanding student loan debt in the United States topped \$1 trillion in 2011, comprised of about \$864 billion of federal student debt and \$150 billion of private student loan debt.³

³Press Release, “Consumer Financial Protection Bureau and U.S. Department of Education Joint Report Finds a Cycle of Boom and Bust in Private Student Loan Market” (July 20, 2012).

Private student loans are almost always more expensive over the long term than federal loans. This is especially true for borrowers with lower credit scores or limited credit histories. Federal loans come with a range of borrower protections that are mandated in the federal Higher Education Act, including income-based repayment, deferment and cancellation rights. In contrast, private student lenders are not required to offer any particular relief.

The private student loan market declined in recent years after a relatively long boom. The College Board reports that after peaking at 25% of total education loan volume in 2006-07, nonfederal loans declined to 8% of all student loans in 2009-10 and 7% in 2010-11.⁴ More recently, however, lenders have reported a return to growth and increased competition.

The post-credit crisis landscape is much different. The private student lenders still in business have adopted more responsible business models for the most part. For example, the CFPB found that lenders now require schools to certify the student's need for financing in nearly 90% of private loans.⁵ Lenders have also tightened credit standards and reduced lending to nonprime borrowers. There is no guarantee, however, that this safer market will persist. As the CFPB highlights, lenders' appetite for risk tends to ebb and flow and there is no assurance that as the memory of the financial crisis fades, lenders will maintain responsible lending practices.⁶

The private loan market generated huge profits for lenders and investors largely because originators sold the loans with the intention of packaging them for investors. Prior to the credit crisis, private student lenders engaged in many of the same predatory practices as occurred in the subprime mortgage market. Not surprisingly, the industry began to crash once it could no longer rely on passing off dubious loans through the securitization process. Defaults and delinquencies ballooned during this time and continue to be a major problem. According to the CFPB, default rates on private student loans spiked following the financial crisis of 2008 as the recession "...exposed the weakened underwriting standards that were fueled by the capital markets during the securitization and lending boom."⁷ The default rates have since stabilized, but are expected to remain high. The CFPB concluded in its July 2012 report that defaults on private student loans have increased since the financial crisis and that there are now over \$8.1 billion in defaulted private loans, representing more than 850,000 distinct loans.⁸

Moody's acknowledged in early 2010 that the high default rates for private loan securitizations reflected weak underwriting, referring in this case to the 2006-07 period.⁹ "Non-traditional" students or those attending "non-traditional" schools had a large portion of the defaulted loans, but many students graduating from traditional colleges and universities have also struggled under unsustainable loan burdens. As the CFPB concludes, both consumers and creditors lose when loans cannot be repaid.

⁴ CollegeBoard, "Trends in Student Aid 2011" (2011).

⁵ Consumer Financial Protection Bureau, "Private Student Loans" at 70 (July 20, 2012).

⁶ Id.

⁷ Id. at 63.

⁸ Id. at 64.

⁹ Student Lending Analytics Blog, "Moody's Outlook for Student Loan Securities: Expect Negative Credit Trends for Private Loans in 2010" (Jan. 29, 2010).

In addition to third party student lending, some states offer their own private loan programs. In New York, for example, the New York Higher Education Financing Authority issues private bonds to purchase loans made by private lenders that participate in the program.¹⁰ Participating lenders must sign agreements to make loans in accordance with the program guidelines. Loan rates are set by the New York State Education Department and are determined by credit score. Interest rate maximums cannot exceed 16.5%.¹¹

State lenders that responded to the recent CFPB report claim to provide greater protections to consumers and more relief options. The CFPB report affirms that the default rates for non-profit, state-affiliated lenders in its data set were about half that of their for-profit counterparts.

Institutional Loans: Compounding the Pain for Borrowers

As the subprime student loan market contracted, many schools began to develop their own products. Institutional loans are another type of private student loan. While exact numbers are difficult to come by, the College Board attributes much of the growth to lending by for-profit schools.¹² Overall, the College Board estimates that institutional loans have grown from about \$500 million in 2007-08 to \$720 million in 2010-11.¹³

As documented in NCLC's January 2011 report, "Piling It On: The Growth of Private Student Loans and the Consequences for Students", the planned default rates on these school loan products are shockingly high.¹⁴ For example, at the beginning of FY 2009, Corinthian Inc. expected a loan default rate on its school loan product of 50% -- before it even made the loans.¹⁵ Corinthian adjusted this estimate to 55% for FY 2009 and predicted a range of 56 to 58% in 2010.¹⁶ At nearly one-third of Corinthian campuses, more than half of all first year students took out high-cost private student loans in 2009.¹⁷

Other schools have also made institutional loans with exorbitant default rates. Analysts have estimated that ITT may assume close to a 45% loss rate or even higher on institutional loans.¹⁸

¹⁰ N.Y. Educ. Law § § 690-694-b; N.Y. Comp. Codes R. & Regs. Tit. 8, § § 2231.1-2213.28. See also New York Higher Education Loan Program Underwriting Manual (August 25, 2010).

¹¹ N.Y. Comp. Codes R. & Regs. tit. 8 § 2213.9.

¹² College Board, "Trends in Student Aid 2011" at 13 (2011).

¹³ Id.

¹⁴ National Consumer Law Center, "Piling It On: The Growth of Proprietary School Loans and the Consequences for Students", (January 31, 2011), available at: <http://www.studentloanborrowerassistance.org/blogs/wp-content/www.studentloanborrowerassistance.org/uploads/File/proprietary-schools-loans.pdf>.

¹⁵ The amount discounted against revenue (the discount rate) is the estimated loan default rate. See generally Corinthian Colleges Q2 2009 Earnings Conference Call Transcript (Feb. 3, 2009).

¹⁶ Q42009 Corinthian Colleges Earnings Conference Call (Aug. 25, 2009).

¹⁷ Stephen Burd, "Updated: New Data on Private Loan Borrowing at Corinthian Colleges Should Raise Alarms", New America Higher Ed Watch (June 17, 2011).

¹⁸ PAA Research LLC, "ESI: Connecting the Dots on ESI's Increasingly Worrisome Off-Balance Sheet Exposure-The Potential 'Daisy Chain' of Events" (June 21, 2011).

However, ITT claims that it is phasing out its institutional loan program and has not originated new loans through the program as of July 2011.¹⁹

Schools seem to view these loans as “loss leaders” that keep the federal dollars flowing. Among other reasons, for-profit schools must show that at least 10% of revenues come from sources other than federal student aid provided by the U.S. Department of Education. Since many of these schools generate revenues and profits almost exclusively from federal funds, compliance with the 90-10 rule is a lifeline for them and their investors. The school can comply with this rule by inflating their tuition and loaning the amount not covered by federal loans and grants, even if many of these loans get written off as bad debt. As CFPB’s Assistant Director for Military Affairs Holly Petraeus has highlighted, this has also led to aggressive targeting of the military service member market as Department of Defense education funds are not currently included in the 90% category.

However, the growth of institutional lending is not only about the 90-10 rule. It is also a way for schools to keep revenues of all types flowing so that profits remain high and the companies remain attractive to investors.

Making unaffordable loans harms student borrowers who generally face numerous collection calls, lawsuits and negative entries on their credit reports that can last for extended periods of time. Many schools require students to make payments on institutional loans while in school. This places many students in a trap. Many cannot pay the monthly payments on institutional loans while they are in school and as a result are often terminated from the schools or are denied transcripts. In contrast, most third party private and all federal loans can be deferred during school. Interest may accrue, depending on the type of loan, but payment is not required.

According to CFPB Director Richard Cordray, “One of the things we see and have seen is lenders who market loans for borrowers knowing that those borrowers are unlikely to be able to pay those loans...But they have other incentives that lead them to make those loans nonetheless. We clearly saw that in the mortgage market in the run-up to the financial crisis, when that market got broken.”²⁰ Following through on these concerns, the CFPB issued a civil investigative demand to ITT Educational Services focusing in part on student loan origination. The CFPB is also investigating Corinthian Colleges.

Who Borrows Private Student Loans and Why?

We began to see a growing number of low-income clients with private student loans about ten years ago. Many clients had multiple loans with large balances. Most of these loans were third party loans.

Based on our experience, borrowers rarely understand the difference between private and government loans. Those who co-sign private student loans are particularly likely to be confused

¹⁹ ITT Educational Services, Inc., 10-Q at 10 (October 21, 2011).

²⁰ Edward Wyatt, “Some Lenders to Students Face Greater U.S. Scrutiny”, New York Times (Jan. 12, 2012).

about the scope of their obligations. In one case, a monolingual Spanish speaking client earning minimum wage co-signed multiple private loans for her daughter's education. Her daughter attended a private non-profit college in the Boston area with a tuition of over \$25,000/year. She attended for only about 1 ½ years, dropping out because of concerns about affordability. The client had previously taken out a PLUS loan and thought the private loan was another PLUS loan.

At least in part due to the confusion between federal and private loans, the majority (52%) of private student loan borrowers in 2007-08 borrowed less than they could have in federal Stafford loans.²¹ In 2007-08, 25% of private loan borrowers took out no Stafford loans at all and 13% did not apply for federal financial aid.²²

A high percentage (about 70 -75%) of our clients attend for-profit schools. These schools have had the largest proportion of students taking out private loans and the largest increase in private loan borrowing. Forty-two percent of all for-profit school students had private loans in 2007-08, up from 12% in 2003-04.²³ In contrast, 25% of students at private non-profit four year schools, 14% of students at public four year schools and 4% of students at public two year schools had private student loans in 2007-08.²⁴ In 2007-08, for-profit school students comprised about 9% of all undergraduates, but 27% of those with private loans.²⁵

Some lenders and financial aid office staff tout private loans as an easier alternative to federal loans. In a 2006 report, the Institute for Higher Education Policy noted that students may perceive private loan borrowing to be more convenient than federal loans. Among other reasons, borrowers do not have to fill out the Free Application for Federal Student Aid (FAFSA) form to get private loans.²⁶ "It was like signing up for iTunes", according to one student.²⁷

Students and Families are Confused about Student Loan Options

The Consumer Financial Protection Bureau's collection of complaints about private student loans indicates high levels of confusion among borrowers regarding their loans and the financial aid process. Many borrowers did not know the rules for federal aid eligibility and some could not identify whether they had federal or private loans.²⁸ In its July report, the CFPB again emphasized that consumers consistently reported an inability to recognize the crucial differences between federal and private student loans.

²¹ The Project on Student Debt, "Private Loans: Facts and Trends" (July 2011).

²² Id.

²³ The Project on Student Debt, "Private Loans: Facts and Trends" (July 2011).

²⁴ Id.

²⁵ Id.

²⁶ Institute for Higher Educ. Policy, "The Future of Private Loans: Who is Borrowing, and Why?" at 22 (Dec. 2006).

²⁷ Janet Lorin, "Students Pay SLM 9.25% or JPMorgan 10.25% from Exploitive Loans", Bloomberg (June 5, 2012).

²⁸ Rachel Fishman, "What Borrowers Don't Understand About Student Loans May Hurt Them" Higher Ed Watch (June 18, 2012).

In the worst cases, school financial aid officers or other school staff provides inaccurate information in order to lure borrowers into private loans or otherwise pressure borrowers to take out these loans. Particularly during the heyday of predatory lending, many lenders aggressively marketed their student loan products directly to consumers and schools promoted “approved” lenders that gave kickbacks to the school. Private student lending, particularly prior to the credit crisis, became very much a push market in which products were offered not only in response to consumer need but also to fulfill investor demand.²⁹ The CFPB notes that the securitization market for student loans during the boom years was similar to the mortgage securities market in many respects, including the market incentives to increase approval rates by lowering minimum credit scores. According to the CFPB, “Simply put, during the boom, lenders made a high percentage of loans to weaker credits. Today, only a very good credit is likely to be approved.”³⁰

A mandatory certification process is one way to address some of the confusion about student loans and to curb over-borrowing. Lenders report that asking schools to certify a private loan commonly reduces the loan amount because the borrower was not eligible to borrow the amount requested. Some schools use the certification process to counsel students about the risks of private loans and other issues. In a 2011 report, the Project on Student Debt found that college financial aid offices can play a significant role in reducing their students’ reliance on private loans.³¹ In its recent report, the CFPB concludes that the credit quality of loans that are not school certified is materially worse than average.³²

The current certification-related provisions in the Truth in Lending Act (TILA) are insufficient. TILA includes a provision requiring creditors to obtain a self-certification form with information about cost of attendance, the expected family contribution and estimated financial assistance.³³ However, the information on the self-certification form does not have to come from the applicant’s school or be verified in any way. In fact, lenders are allowed to provide pre-filled self-certification forms directly to borrowers.³⁴ Mandatory school certification would be more effective in ensuring that borrowers are aware of federal student loan eligibility before taking out private loans.

Disclosures Can be Helpful, But Are Not Enough to Ensure a Fair and Transparent Marketplace

Effective February 14, 2010, lenders making private student loans are required by TILA to provide special disclosures.³⁵ There are three sets of required disclosures: 1) application and

²⁹ See generally National Consumer Law Center, “Paying the Price: The High Cost of Private Student Loans and the Dangers for Borrowers” (Mar. 2008), available at http://www.studentloanborrowerassistance.org/blogs/wp-content/www.studentloanborrowerassistance.org/uploads/File/Report_PrivateLoans.pdf.

³⁰ Consumer Financial Protection Bureau, “Private Student Loans” at 22 (July 20, 2012).

³¹ The Project on Student Debt, “Critical Choices: How Colleges Can Help Students and Families Make Better Decisions About Private Loans” (July 2011).

³² Consumer Financial Protection Bureau, “Private Student Loans” at 25 (July 20, 2012).

³³ Reg. Z § 226.48(e).

³⁴ Official Staff Commentary on Regulation Z, 12 C.F.R. § 226.48(e).

³⁵ 15 U.S.C. § 1638(e); Reg. Z § 226.46.

solicitation; 2) loan approval; and 3) final disclosures. Each is subject to special timing rules and detailed form and content requirements.

The new disclosure rules are a significant improvement for consumers. Among other changes, the disclosures must be given prior to consummation and include more detailed information about cost and repayment options.

However, the new disclosures still leave much to be desired. For instance, the disclosures focus on interest rates, rather than APRs that include fees. In addition, the current scope is too narrow, primarily because it excludes open-end credit. This is problematic particularly as lenders create new products, in many cases offered as open-end credit or disguised as open-end credit. Moreover, there has been limited enforcement and investigation to determine whether private lenders are complying with the new regulations and if they need to be improved.

In addition to TILA disclosures, the CFPB's "Know What You Owe" campaign is a very promising step in improving the information available for prospective borrowers. The CFPB's Student Debt Repayment assistant site is another excellent tool for borrowers seeking to understand the differences between federal and private loans.

Nonetheless, disclosures are never enough to provide substantive protection for borrowers. In a market full of securitized, complex products often made for Wall Street, not Main Street, borrowers cannot rely on disclosures to ensure they get the loan they want and can afford. I have attached a summary of substantive policy recommendations at the end of my testimony.

Financially Distressed Private Student Loan Borrowers Have Nowhere to Turn

Student loan creditors have pushed hard to limit the safety net for borrowers who get in trouble. One of the most notable examples is the 2005 Congressional decision to make private student loans as difficult to discharge in bankruptcy as federal loans. Since 2005, nearly all student loan borrowers must prove "undue hardship" in court in order to discharge their loans. Courts have been very restrictive in applying this standard.³⁶

Private student loan borrowers seeking to prove undue hardship often encounter judges who do not understand the difference between federal and private loans. The judges may deny hardship cases based on a mistaken belief that the borrowers have the same flexible repayment and other options as federal student loan borrowers.

³⁶ See generally National Consumer Law Center, "No Way Out: Student Loans, Financial Distress and the Need for Policy Reform" (June 2006), available at: <http://www.studentloanborrowerassistance.org/uploads/File/nowayout.pdf>; Testimony of NCLC and NACBA before the U.S. House of Representatives Committee on the Judiciary, "Undue Hardship? Discharging Educational Debt in Bankruptcy" (September 23, 2009), available at: http://www.studentloanborrowerassistance.org/blogs/wp-content/www.studentloanborrowerassistance.org/uploads/File/policy_briefs/testimony_bankruptcy_sept09.pdf.

Collectors often tell our clients that they have nowhere to go because they cannot get bankruptcy relief. The lenders and collectors therefore use the limited bankruptcy relief as a weapon to pressure financially distressed borrowers. A major step in providing relief for borrowers is for Congress to restore bankruptcy rights for student loan borrowers.

The bankruptcy policy might not be so harsh if borrowers had ample non-bankruptcy alternatives to address student loan problems. Given their role in creating the crash, it is reasonable to expect lenders to do everything possible to help borrowers with unaffordable loans. Distressingly, this has not occurred. In NCLC's experience representing borrowers through the Student Loan Borrower Assistance Project, we have found private lenders to be inflexible in granting long-term repayment relief for borrowers. Lenders that had no problem saying "yes" to risky loans are having no problem saying "no" when these borrowers need help.

The most common complaint we hear is that the lenders do not offer meaningful relief. Here are a few voices (e-mails reprinted verbatim) from borrowers contacting us through our web site.

Borrower in Ohio: "I have a private loan with Sallie Mae that allowed me to defer due to economic hardship. All of a sudden it would not allow me to do so and my loan went into default... They have told me to stop paying other bills and to do what I have to do to get the money..They have also told me to take other loans or sell my belongings to get the money., I have nothing except too much debt to income at this time to be able to do so. They tell me to make an offer, but what I can do at this time never works for them...it's their way or no way and it doesn't matter if I'm put out on the street or left to starve."

Borrower in Sacramento, CA: "I need an income-based refinance plan, but I haven't found one available for my private loan...Please help me find, or create a solution!!!"

Borrower in Turner Falls, MA: "I'm writing to support: H.R. 2028: Private Student Loan Bankruptcy Fairness Act of 2011.

"I graduated with a Bachelors degree in 2008. After graduation I could not find a job because of the poor economy. I searched for jobs daily; I had sent out hundreds of resumes to no avail. I ended up having to pay Sallie Mae \$150.00 (that I didn't have) every 3 months for them to grant me a forbearance! That money did NOT go to the principal balance of the loan, it was theirs to keep as well as interest that was accruing due to my involuntary hardship.

"After 2 years of being unemployed I finally obtained a part-time job as a Network Technician, making \$13.00 an hour. I struggled to pay bills and old debt (not including student loans). At this time I was forced to continue the forbearance on my education loans; both Federal and Private. I did not make enough money to keep Sallie Mae satisfied. I tried to work out payment plans, but they wanted too much money that I couldn't afford. The payment went up as the interest piled up.

“As of today, I have accrued more than \$30,000 in interest with Sallie Mae. My loan went from roughly \$90,000 to \$120,000 during the years I was unemployed. I continued the \$150.00 forbearance “bribes” until late June 2011 when Sallie Mae told me that I had exhausted my forbearance period. I still cannot pay \$1000 a month to them.

“I’ve tried numerous times to work things out with Sallie Mae; they will not work with me on this issue. Needless to say, the phone calls from Sallie Mae are endless and harassing. I have been yelled at, degraded, and verbally abused by their debt collectors, but I see no end to this downward spiral of college debt. (I’m not even working in my field of study).

“I want to live the “American Dream.” I want a small house with a picket fence; a golden retriever; a decent job. I do not see the “American Dream” in my future at all.”

In all of our efforts working with many borrowers and many lenders, we have not encountered any private student lender with a rehabilitation program or any other program to allow borrowers to get out of default and back into repayment. The CFPB reported that there were no current cure programs for private student loans.³⁷ According to comments submitted to the CFPB, some state programs have rehabilitation options. However, some state lenders told the CFPB that capital markets funding their loans limited their flexibility in providing relief.³⁸

Servicing Problems

A common complaint we hear from borrowers is that they are unable to obtain even basic information, such as amounts owed and paid, from their private student lenders or servicers. A borrower from Franklin, NY contacting us through our web site summarized this problem concisely: “I have a private loan that has been passed around and I can’t seem to get ahold of anyone about it.” The CFPB noted that many respondents in its survey discussed challenging repayment experiences with servicers.³⁹

Unfortunately, private loan borrower rights to fair billing and accounting statements are not as clear or strong as for federal loans. For example, federal student lenders are required to respond within thirty days to any inquiry from a borrower on a loan. There are also dispute resolution procedures set out in the Higher Education Act.⁴⁰ These are essential rights for borrowers that need basic information about what they owe on loans, how much they have paid, and how they can dispute possible errors.

In addition, we are increasingly hearing from borrowers that they get the run-around when trying to work out solutions with lenders. This is particularly common when loans have been securitized and it is unclear which entity has authority to modify loans. As in the mortgage market, it is critical to investigate how and why servicers are failing to provide relief for

³⁷ Id. at 13, 66.

³⁸ Consumer Financial Protection Bureau, “Private Student Loans” at 32 (July 20, 2012).

³⁹ Id at. 70.

⁴⁰ 34 C.F.R. § 682.208(a).

borrowers. Various attempts to address the foreclosure crisis have failed in part because they do not address the misaligned incentives of servicers. We need more information to evaluate whether similar issues are incentivizing student loan servicers to delay or deny modifications that make sense for borrowers and investors.

Lack of Repayment Relief

Unfortunately, private lenders have been generally inflexible in trying to assist financially distressed borrowers.⁴¹ Unlike the federal student loan programs, there is no federal law requiring private student lenders to offer particular types of relief or flexible repayment. Private student loan borrowers are generally at the mercy of their creditors.

None of the loan notes we surveyed in our 2008 report, “Too Small to Help: The Plight of Financially Distressed Private Student Loan Borrowers” specifically provided for income-based repayment.⁴² A few stated that borrowers would be able to choose alternative repayment plans in certain circumstances. However, the specific criteria and circumstances were not spelled out in the agreements. Only a few mentioned that graduated repayment was possible. In these cases, the loan contract stated that these plans would be offered only if available. There was no information provided about when such plans were available.

Even in cases of severe distress, the creditors we have contacted have offered no more than short-term interest-only repayment plans or forbearances. This experience holds true for both for-profit and non-profit lenders. Some offer short-term interest-only payment options that merely prolong inevitable defaults, particularly for borrowers with large loan balances.

Private Loan Deferrals and Forbearances

Unlike federal loans, there is no federal law requiring private student loan creditors or servicers to offer deferments or forbearances. In a 2008 study, the National Consumer Law Center surveyed private loan notes and found that most lenders provided an in-school deferment option.⁴³ However, interest generally accrued during this period, and borrowers were given the choice of paying the interest while in school or approving capitalization once they entered repayment. Since the economic crisis of 2008/2009, many lenders that are still offering private student loans are now requiring borrowers to pay interest while in school.

No forbearance rights were specified in nearly half of the loans in the NCLC survey.⁴⁴ Creditors may offer these plans, but they do not inform borrowers about available choices ahead of time in the loan notes. A number of lenders in the survey disclosed that they would charge

⁴¹ See generally National Consumer Law Center, “Too Small to Help: The Plight of Financially Distressed Private Student Loan Borrowers” (Apr. 9, 2009), available at <http://www.studentloanborrowerassistance.org/blogs/wp-content/www.studentloanborrowerassistance.org/uploads/File/TooSmalltoHelp.pdf>.

⁴² National Consumer Law Center, “Paying the Price: The High Cost of Private Student Loans and the Dangers for Student Borrowers”(Mar. 2008).

⁴³ National Consumer Law Center, “Paying the Price: The High Cost of Private Student Loans and the Dangers for Student Borrowers”(Mar. 2008).

⁴⁴ *Id.*

fees to process forbearance and deferment requests. The fees were generally up to \$50 for forbearances. Under pressure from an online campaign earlier this year, Sallie Mae agreed to make changes in its forbearance fee policy.⁴⁵ The company said it would continue to charge the fees, but would apply the payments to customer balances in certain circumstances.

Most creditors have sharply restricted forbearance availability since 2008. In a 2009 report, Fitch noted that lenders began to impose more restrictive forbearance criteria starting in 2008 after realizing that the economic downturn would have a more prolonged impact on a borrower's ability to repay.⁴⁶ According to the CFPB, some lenders reported that they were constrained by certain regulators from treating loans in extended forbearance as performing assets.⁴⁷

Modifications and Settlements

Private student loan borrowers need flexibility to prevent and address delinquency and default. Yet, in our experience representing borrowers in financial distress, most lenders, including non-profit lenders, have not been willing to cancel or modify loans or offer reasonable settlements. The CFPB found in its July 2012 report that the lenders in its sample did not currently offer loan modification programs.⁴⁸ We have found that the lenders require very large lump sums to settle debts even from borrowers with very low incomes.

A lender's failure to have a loan modification program and other practices to help distressed borrowers is an element or sign of unfair origination and underwriting practices. Speculative projections of future income made as part of determining ability to pay also require a plan for contingencies if the student's income is not – either temporarily or permanently – as projected. Loan modifications that enable a student to make payments on a loan rather than completely defaulting are in both the students' and the lenders' best interests, but as we have seen in the mortgage market, sometimes industry needs a push to come up with a win-win solution.

Modifications may lead to lost revenues for servicers, but in many cases the losses will be much greater if the servicer refuses assistance. Many borrowers are financially destitute with little or no future earnings prospects. Some are severely disabled or otherwise unable to work. Yet servicers remain largely unaccountable for their dismal performance in making modifications.⁴⁹

In some cases, we hear from servicers that they do not have the authority to accept a settlement offer. This is an unacceptable and unproductive response to a borrower looking for

⁴⁵ Tamar Lewin, "Online Campaign Prompts Sallie Mae to Change Fee Policy for Loan Suspensions", *The New York Times* (Feb. 2, 2012).

⁴⁶ Fitch Ratings, "Private Education Loans: Time for a Re-Education" at 6 (Jan. 28, 2009).

⁴⁷ Consumer Financial Protection Bureau, "Private Student Loans" at 65-66 (July 20, 2012).

⁴⁸ Consumer Financial Protection Bureau, "Private Student Loans" at 66 (July 20, 2012).

⁴⁹ For a discussion of this problem in the mortgage context, see National Consumer Law Center, "Why Servicers Foreclose When They Should Modify and other Puzzles of Servicer Behavior" (Oct. 2009).

help. Servicers that claim to lack authority to modify loans should put the borrower in touch with the owner or entity that does have such authority.

Some lenders and servicers have discussed settlement with us. In every case, the lender has requested at least 80% of the total balance as settlement. This is far beyond an amount our clients can afford. In rare cases, we have represented low-income clients who have been able to raise significant funds to settle debts. Even these offers have been rejected. We do not understand why a creditor would reject substantial funds from a low-income consumer, particularly since the creditor is unlikely to recover much if anything from these consumers.

Just as in the mortgage industry, there seem to be institutional barriers to finding the win-win situation that puts borrowers back on the track of repaying their loans. Laws and regulations that require private student lenders to have workable repayment programs for financially distressed borrowers may be necessary to jump start this process.

Mandatory loss mitigation can be justified both as a matter of ability to repay and as a safety and soundness issue. Because a student's future income cannot be known at the time of loan origination, responsible lending requires safety valves that ensure that the loan will be affordable even if initial projections turn out wrong. From a safety and soundness perspective, as well, institutions need to anticipate the possibility that the loan debt may prove unsustainable for some borrowers and to put in place programs to turn those loans into performing loans rather than write-offs.

This may involve addressing barriers in accounting or other safety and soundness standards to facilitate modifications. For example, Student Loan Corporation announced in public filings that the Office of the Comptroller of the Currency reviewed forbearance policies on private student loans and recommended a number of proposed changes including more rigorous requirements for participation in forbearance and loss mitigation programs, shorter forbearance periods and the requirement for minimum periods of payment performance between forbearance grants.⁵⁰

Loan Cancellations Outside of Bankruptcy

Pursuant to statute and Department of Education regulations, federal student loans can be cancelled if the borrower dies or becomes severely disabled. Similar programs are only available at lender discretion for private loans. The documents from a number of loans that we reviewed for our 2008 study stated explicitly that there will be no cancellation if the borrower or co-signer dies or becomes disabled.⁵¹

A few lenders have said they will cancel loans in very rare circumstances. For example, Sallie Mae announced in 2010 that it had hired a company to administer claims for a new total

⁵⁰ See Student Lending Analytics Blog, "OCC Tightens Forbearance Policies on Private Student Loans" (Jan. 19, 2010).

⁵¹ National Consumer Law Center, "Paying the Price: The High Cost of Private Student Loans and the Dangers for Student Borrowers" (Mar. 2008).

and permanent disability program for private education loans.⁵² This program, however, applies only to the Smart Option Student Loans. The company also announced that it would forgive any unpaid balance in the event of a primary borrower's death. It is unclear whether this policy is being administered consistently.

Wells Fargo announced a similar program in December 2010, stating that it would require verbal or written notification of a student's death or permanent and total disability followed by receipt of acceptable documentation. The forgiveness, according to Wells Fargo, covers the death or disability of the student, leading to forgiveness of not only the student's obligation, but also the obligation(s) of any co-signers.⁵³

However, the companies to date have not provided public information about eligibility and application requirements. We do not know of any investigation as to whether these programs are described in writing in loan agreements or elsewhere and whether the lenders are following up on their promises.

A few recent media reports have highlighted families grieving after losing a child and also having to deal with private student loan debts. In one case, the son had been the pride of his family, according to the article, and the first to go to college.⁵⁴ He tragically died in a car accident. The government discharged the federal student loans, but the bulk of the son's loans were private.

A grieving mother recently wrote to us:

Two days after Christmas we tragically lost our only daughter in a car accident. She was just 24 years old. She completed her college degree as a Social Worker, an occupation that wasn't going to make her rich in money, but in her words what counted most, helping others. Although she volunteered as a City Year corp member for two years, she never really got the chance to make the impact she came here to make before she was taken from us.

Like so many other students, she was mired in student loan debt after graduation...Needless to say our family has been devastated by this tragedy. While we're still dealing with our loss and the pain and devastation it's caused our family we are also dealing with the legal troubles that come when a young person dies with barely any accumulated assets but like so many recent graduates, increasing student loan debt. I co-signed for her loans to help her complete her degree and to fulfill our dream of having that piece of paper on our wall. I signed never thinking she wouldn't be able to repay the loan on her own.

⁵² See Securian Company News Release, "Securian Wins Contract for Administering Total and Permanent Disability Claims on Private Student Loans" (March 8, 2010).

⁵³ See Wells Fargo, News Release, "Wells Fargo Enhances Student Loan Products to Include Loan Forgiveness" (Dec. 17, 2010)

⁵⁴ Marian Wang, "Grieving Father Struggles to Pay Dead Son's Student Loans", Pro Publica (June 14, 2012).

This case illustrates the current haphazard approach in these tragic cases. One of the private lenders sent condolences and discharged the debt. The other lender told this mother that there was no such cancellation option.

As with loan modifications, the presence of a program for disability and death discharges is part of assessing whether lending is designed at the outset to be based on ability to pay. Discharges in case of the student's death are particularly important to prevent deception and unfairness for parents who do not expect to be liable, and should not be, for a loan after the student dies.

School-Related Cancellations

The right to assert defenses to repayment of the loan when the school fails to deliver on its promises is especially important when private lenders have close ties to for-profit schools that promote, package or help the lender market their private loan products. In these cases, borrowers are often unable to obtain relief directly from schools, many of which are out of business or insolvent by the time borrowers seek redress. Even borrowers who successfully obtain damages from an unscrupulous school are often left with significant loan debt.

A key to lender liability in many cases is the FTC holder rule. The holder rule (more accurately referred to as the Federal Trade Commission Preservation of Claims Rule), puts lenders on the hook when they have "referring relationships" with schools that defraud students or shut down unexpectedly.⁵⁵ The holder rule gives lenders an incentive to scrutinize the schools with which they have close relationships and to originate loans only with upstanding schools. This helps promote responsible lending. Under the FTC holder provision, students who have claims or defenses that they could have raised against the school can raise them against the lender. The lender's liability is capped, though: at most the student borrower can recover any payments made and have the remaining indebtedness canceled, even if the borrower's damages are greater.

Similar relief is available for most federal loans. Yet, private student lenders have sought numerous ways to avoid this type of liability, including hiding behind preemption arguments. Many simply do not include the holder notice in the loan notes. Nearly 40% of the loans in our 2008 survey followed this potentially illegal approach.⁵⁶ Other lenders include the notice but attempt to deny borrowers its benefits by placing contradictory clauses in the notes. In our survey, 90% of the notes that included the FTC notice undermined it in some way by attempting to prohibit borrowers from raising defenses. I have attached a few examples of contradictory language in third party and institutional private student loans at the end of my testimony.

Because the FTC does not have jurisdiction over banks, the holder rule only applies to schools, not depository lenders. That is, the FTC rule obligates only the schools, not the lenders, to include the holder notice in the contract. In general, the school must insert the notice in

⁵⁵ 16 C.F.R. §433.2.

⁵⁶ National Consumer Law Center, "Paying the Price: The High Cost of Private Student Loans and the Dangers for Student Borrowers" (March 2008).

consumer credit agreements whenever the school originates the extension of credit and must arrange for the lender to insert the notice in the lender's credit agreement whenever the school refers the consumer to the lender or otherwise has a business arrangement with the lender.

An example of this concern can be seen in a recent letter from AES, which was servicing one of our client's Chase private student loans. The school this client attended had referred him to Chase for the loan. Yet AES replied that it was unable to do anything. AES states in its letter that it understands that the client is seeking the possibility of a settlement and that it empathizes with the client's situation in regards to the alleged misrepresentation made by the school. However, according to AES, "We are unable to cancel the debt incurred. Pursuant to Section L. Additional Agreements of the Credit Agreement, it states, 'If I fail to complete the education program paid for with this loan, I am not relieved of any obligation within or pursuant to this Application/Promissory Note.' Your client may wish to seek resolution from the school itself."

When we contacted Chase about this client, Chase wrote back stating that we should contact the school regarding any practices in regards to the education it provided. According to Chase's letter, "We are only a lender and servicer. Funds are disbursed upon the school's certification. Once certified, we have no further correspondence with the school."

Out of Control Collection Practices

Instead of working with borrowers, many lenders increase collection activity against financially distressed borrowers. In 2008, Sallie Mae, for example, announced steps to resolve higher risk accounts, including a more aggressive use of collection efforts.⁵⁷

There are serious collection abuses in both the federal and private student loan industries. In the private student loan industry, many violations occur due to collectors' inaccurate claims about their collection powers. It is particularly common for collectors of private student loans to claim that they can use collection tools unique to federal loans, such as Social Security offsets.⁵⁸

In addition, some private lenders attempt to charge collection fees for private student loans that are similar to the very high levels allowed in the federal loan program. These lenders may attempt to collect as much as 25% of loan balances even if they have exerted little or no effort to collect.⁵⁹ This may violate state laws and/or contract provisions limiting collection fees. Further, packing on collection costs inflates the loan balance so that many borrowers will never be able to make a dent in the debts. They become stuck in a spiral where the payments they make only pay off the collection fees. Interest continues to accrue and the overall debt balloons. Other common problems include:

1. Private lender misrepresentations that there is no statute of limitations for private student

⁵⁷ Paul Basken, "Sallie Mae Reports \$159-Million Loss and More Delinquencies by Borrowers", *The Chron. of Higher Educ.* (Oct. 23, 2008).

⁵⁸ See, e.g., *Strom v. National Enterprise Systems, Inc.*, 2011 WL 1233118 (W.D.N.Y. March 30, 2011) (Alleging that collector of private student loan advised that it would seize plaintiff's SSDI funds in bank account).

⁵⁹ See, e.g., *Bottoni v. Sallie Mae, Inc.*, 2011 WL 635272 (N.D. Cal. Feb. 11, 2011).

loan collection. We frequently hear this from our clients. The debt collector may say something like, “This debt will never go away” or “we have the right to come after you forever.”

2. Misrepresentations that defaults on private student loans limit eligibility for new federal student loans and grants.
3. Misrepresentations that the defense of infancy does not apply. This defense arises when the borrower is too young to enter into a binding contract. There is a specific infancy defense exclusion for federal student loans, but not for private.⁶⁰
4. Co-signer complaints. Most private lenders now require co-signers. Many of the borrowers who contact us through our web site are co-signers, often parents. They are often confused not only about the scope of their obligations, but also inconsistent and in some cases inaccurate promises about removing cosigners from accounts.

In the increasingly aggressive collection environment, we are hearing more complaints from borrowers and their attorneys that the entities suing to collect do not actually own or hold the loans. This is frighteningly reminiscent of the recent robo-signing scandal in the mortgage market. Among other practices, plaintiffs in litigation have been unable to prove that the private student loans were in fact properly assigned to them.

Common Problems with Private Student Loan Terms

1. Unfair and abusive default triggers, such as universal default clauses

Borrowers are in default on federal loans if they fail to make payments for a relatively long period of time, usually nine months. They might also be in default if they fail to meet other terms of the promissory note. There are no similar standardized criteria for private loan defaults. Rather, default conditions for private student loans are specified in the loan contracts. In most cases, borrowers will not have a long period to resolve problems if they miss payments on a private student loan. Private loans may go into default as soon as one payment is missed. This severely limits borrowers’ opportunities to try to resolve problems and opens them up to onerous collection tactics, credit damage, and possible litigation.

A few of the default “triggers” in the loans we reviewed in our 2008 report were particularly troubling.⁶¹ For example, the typical loan we reviewed stated that borrowers could be declared in default if “in the lender’s judgment, they experience a significant lessening of ability to repay the loan” or “are in default on any other loan they already have with this lender, or any loan they might have in the future.” The last category closely resembles the heavily

⁶⁰ See 20 U.S.C. § 1091a(b)(2) (Higher Education Act exclusion of infancy defense).

⁶¹ National Consumer Law Center, “Paying the Price: The High Cost of Private Student Loans and the Dangers for Student Borrowers” (March 2008).

criticized “universal default clause” that were common in many credit card agreements. A borrower could be current on the student loan, but still declared in default based on a different loan or credit product. This is particularly problematic as large student lending companies begin to develop a range of student financing products, including tuition assistance plans.

2. Mandatory Arbitration Clauses

Sixty-one percent of the loan notes in NCLC’s 2008 survey contained mandatory arbitration clauses.⁶² These clauses are just one example of lenders’ systematic strategy to limit a borrower’s ability to challenge problems with the loans or with the schools they attend.

We strongly recommend a ban on forced arbitration, which is unfair, deceptive and abusive in the student loan context for the same reasons that it denies access to justice for other financial products.

Lack of Reliable Data about Private Student Loans

There is no comprehensive database on private loans, comparable to the government’s National Student Loan Data System. Lenders do not publish proprietary data on their loans. The national data that is available is based on various estimates or infrequent surveys. The College Board, for example, uses data from an informal pool of the largest non-federal loan sponsors.⁶³ Recently, the Department of Education began posting on CollegeNavigator.gov private loan data for schools, but these data are for first-time, full-time students only and appear to be highly unreliable and inconsistent.⁶⁴ The lack of this type of information in the private student loan context is a major impediment to understanding the scope of the problem and helping borrowers.

Among other strategies, we agree with the recommendations in the July 2012 CFPB report to provide mechanisms for borrowers to understand a complete picture of their student loans, including the creation of a centralized, publicly accessible data system.

Conclusion

Thank you for the opportunity to testify before the Subcommittee today. Congress and regulators must act now to provide relief for borrowers buried in student loan debt and as the private student loan market recovers, to ensure that the private student loan market that emerges from the credit crisis is fair and efficient.

⁶² Id.

⁶³ See generally College Board, “Trends in Student Aid 2011” (2011).

⁶⁴ Project on Student Debt, “Student Debt and the Class of 2009” at 10-11 (October 2010), available at <http://projectonstudentdebt.org/files/pub/classof2009.pdf>.

Expensive credit does not promote equal access to education. Rising costs of higher education are certainly a major concern, but the answer is not to allow a revival of predatory student lending.

Summary of Recommendations to Protect Private Student Loan Borrowers and Ensure Fair Lending

Origination of Private Student Loans

- Develop and enforce sound underwriting standards ensuring ability to pay.
- Define and act against unfair, deceptive and abusive marketing practices.
- Improve and broaden scope of Truth in Lending Disclosures (TILA) and enforce TILA requirements.
- Require school certification of loans, including notifying borrowers of any untapped federal student loan eligibility.

Servicing

- Encourage and, where appropriate, require loan modification standards for distressed borrowers and discharges in case of death or disability.
- Extend Fair Credit Billing Act rights to private student loan borrowers.

Collection

- Enforce fair debt collection laws for the entire student loan collection market, both federal and private student loans.
- Prohibit deceptive, unfair and abusive default triggers, such as universal default clauses.
- Ban collection actions in inconvenient forums.

Additional Relief for Borrowers and Measures to Promote Responsible Lending

- Enforce the FTC Holder rule giving borrowers defenses against lenders with close relationships with unscrupulous schools.
- Ban mandatory arbitration clauses.
- Push restoration of bankruptcy rights for student loan borrowers.

Data Collection and Research

- Collect data on private student lending, including loan defaults, lender responses to borrower distress as well as campus-level loan volume and pricing.
- Create an accessible data base where borrowers can get information about all student loans.

Education Finance Loan
Private Educational Loan Programs
Entrance Interview for Applying for the Education Finance Loan

School Name: AICASAC

Print Student's Name [REDACTED]

Student's ID# [REDACTED]

-
1. I understand I may be completing the entrance interview prior to being awarded the Education Finance Loan or my completing the promissory note.
 2. I am obligated to repay my Education Finance Loan even if I do not complete the program, am unable to obtain employment, or am otherwise dissatisfied with the education or other services received.
 3. I must repay my loan with all accrued interest and fees.
 4. Repayment will begin following a 6 month grace period after I graduate, withdraw from school, or cease to be enrolled as at least a half-time student.
 5. Effective for applications received on or after March 2, 2009, the interest rate is Libor plus 9.5%, and is adjusted quarterly. Effective for applications received on or after March 2, 2009 there will be a 6% origination fee that is added to my loan. The lender will inform me in a disclosure statement what my interest rates and origination fee will be. Interest rates and origination fees may suddenly be changed by the lender before loans are disbursed.
 6. I must notify the lender (and any subsequent holder of the loan) and my school, in writing, if I change my name, change my telephone number, change my address, change my graduation date, withdraw from school, do not enroll or enroll less than half-time, or transfer to another school.
 7. If I believe I cannot make payments when due, or if I believe I qualify for a deferment or forbearance of my loan payments, I must contact the lender (and subsequent holder of the loan).
 8. If I fail to repay my loan, it will be reported to a National Credit Bureau and have a negative effect on my credit rating. If applicable, I will have to pay additional costs, including but not limited to: collection costs, fees, legal and court costs.

9. I understand this IS NOT a Federal Loan.
10. I have tried to obtain an alternative loan from at least one other source and have been denied. I understand that the rates and fees of the Education Finance Loan may be higher than other private loans.
11. The school has told me that I should utilize all gift (grants and scholarships) aid and federal educational loans prior to applying for any private loan program. If I borrow a private (alternative loan) or federal loans, I should borrow responsibly and compare loan interest rates as fees.
12. I understand that I am more likely to be approved for this loan if I have a credit worthy cosigner.
13. I understand that before I sign the promissory note, I must read the promissory note and disclosure statements for this and every loan.
14. I understand that if I need subsequent loans of any kind, I must reapply and meet the established credit requirements that are in effect at that time. If I am eligible, future loans may not have the same rates, fees, or conditions of my initial loan.
15. My award letter or Student Financial Plan will disclose whether I am pre-qualified for an Education Finance Loan.
16. I understand that the funds borrowed through the Education Finance Loan can never exceed my direct cost of attending school minus other financial aid that I may have received.
17. I understand that after this loan is originated, this loan will likely be sold to the school, an affiliate under common ownership with the school (such as Education Finance I LLC) or an unrelated third party. As long as I continue to meet the requirements of the loan, the borrower benefits applicable to my loan will remain effective after it is sold.
18. I understand that this loan is only available to students attending schools owned directly or indirectly by Education Management LLC.

Student's
Signature/Date



10/22/09

In this Application/Promissory Note, the words "I", "me", "my", and "mine" mean each and every Borrower and Cosigner, individually and collectively, who signed this Application/Promissory Note. The words "you", "your", "yours", and "Lender" mean Bank One, N.A., its successors and assigns, and any other holder of this Application/Promissory Note. "School" means the school named at the top of the first page of this Application/Promissory Note.

A. PROMISE TO PAY: I promise to pay to your order, upon the terms and conditions of this Application/Promissory Note, all principal, interest and other charges set forth herein.

B. LOAN; DISCLOSURE STATEMENT:

1. By signing this Application/Promissory Note, and submitting it to you, I am requesting that you make this loan to me in an amount equal to the Loan Amount Requested plus any Loan Origination Fee described in Paragraph F of this Application/Promissory Note. When you receive my signed Application, you are not agreeing to lend me money. You have the right not to make a loan or to lend an amount less than I am requesting. I agree to accept an amount less than the Loan Amount Requested and to repay that portion of the Loan Amount Requested that you actually lend to me.

2. If you decide to make a loan to me, you will mail me the disbursement check (the "Disbursement Check") and a statement disclosing certain information about the loan in accordance with the federal Truth-in-Lending Act (the "Disclosure Statement"). You have the right to disburse my Disbursement Check through an agent. At your option, you may also make any Disbursement Check co-payable to me and the Cosigner or to me and the School. In addition to other information, the Disclosure Statement will tell me the amount of my disbursement and the amount of the Loan Origination Fee. The Disclosure Statement is part of this Application/Promissory Note. Upon receipt of the Disclosure Statement, I will review the Disclosure Statement and notify you in writing if I have any questions. My endorsement of the Disbursement Check will acknowledge receipt of the Disclosure Statement and my agreement to be legally bound by this Application/Promissory Note.

3. If I am not satisfied with the terms of my loan as disclosed in the Disclosure Statement, I may cancel my loan. To cancel my loan, I will give you a written cancellation notice, together with my unused Disbursement Check or, if I have already endorsed and delivered the Disbursement Check to the School, a good check, payable to you, in the full amount of the Disbursement Check. If I have delivered the Disbursement Check to the School, I cannot cancel more than ten (10) days after I originally received the Disbursement Check. If I give notice of cancellation but do not comply with the requirements of this Paragraph B.3, this Application/Promissory Note will not be canceled and I will be in default of this Application/Promissory Note. (See Paragraph I.)

C. DEFINITIONS:

1. "Disbursement Date" means the date shown on any Disbursement Check you prepare for me (not the date I endorse or negotiate my check).

2. The "Deferment Period" will begin on the Disbursement Date and end on the Deferment End Date.

3. "Deferment End Date" means the date specified below for the applicable loan program (the applicable loan program is stated on the first page of this Application/Promissory Note).

(a) **Education One Undergraduate Alternative Loan Program:** If I have elected the "Immediate Repayment" option (the applicable repayment option is stated on the first page of this Application/Promissory Note), there is no Deferment Period, and my first payment will be 30-60 days after the last disbursement of my loan. If I have elected the "Interest Only" repayment option (the applicable repayment option is stated on the first page of this Application/Promissory Note), then interest payments will begin 30-60 days after the first disbursement of my loan, the "Deferment End Date" will be the date the Student graduates or ceases to be enrolled at least half-time in the School (or another school participating in this loan program), and principal and interest payments will begin 30-60 days after that date. If I have elected the "Full Deferral" repayment option (the applicable repayment option is stated on the first page of this Application/Promissory Note), then the "Deferment End Date" will be 180 days after the Student graduates or ceases to be enrolled at least half-time in the School (or another school participating in this Loan Program). In any event, the Deferment End Date will be no more than 4½ years after the Disbursement Date (or 5½ years if the Student is enrolled in a five-year undergraduate program at the School).

(b) **Education One Graduate Professional Education Loan Program:** 180 days after the Student graduates or ceases for any other reason to be enrolled at least half-time in the School (or another school participating in this Loan Program), but no more than 4½ years after the Disbursement Date; provided, however, that if the Student begins a medical residency or internship during the Deferment Period, then the Deferment Period will end 180 days after the day the residency or internship ends, but no more than 8½ years after the Disbursement Date.

4. The "Repayment Period" begins the day after the Deferment Period ends, (or, if there is no Deferment Period, the day after the Disbursement Date). The Repayment Period is 20 years, unless monthly payments equal to the minimum monthly payment amount (See Paragraph E.4) will repay all amounts owed in less than 20 years, in which case the Repayment Period will be the number of months necessary to pay in full the amount I owe at the minimum payment.

D. INTEREST:

1. Accrual – Beginning on the Disbursement Date, interest on the outstanding balance of this Application/Promissory Note will accrue on the unpaid Loan Amount each day

(including holidays and other days you are closed) at the Variable Rate (Paragraph D.2) divided by the number of days in the year in question.

2. Variable Rate – The "Variable Rate" is equal to the Current Index plus a Margin. The Margins for both the Deferment Period and the Repayment Period are shown on the first page of this Application/Promissory Note. In no event will the Variable Rate exceed the maximum interest rate allowed by the laws of the State of Ohio. The Variable Rate will change quarterly on the first day of each January, April, July and October (the "Change Date(s)") if the Current Index changes. The "Current Index" for any calendar quarter beginning on a Change Date (or for any shorter period beginning on the Disbursement Date and ending on the first Change Date) is based on the London Interbank Offered Rate ("LIBOR") as published in the "Money Rates" section of *The Wall Street Journal*. Each calendar quarter, the index will equal the average of the LIBOR rates published on the first business day of each of the three (3) calendar months immediately preceding such calendar quarter, rounded to the nearest one-hundredth percent (0.01%). If *The Wall Street Journal* was not published or if the LIBOR rate was not published on any one or more of the first business days of each of the three calendar months immediately preceding the calendar quarter, then the Current Index will be determined by using the immediately preceding Current Index. If on any first business day of a calendar month more than one LIBOR rate is published, then the highest rate published will be used to calculate the Current Index. If the LIBOR rate is no longer available, you will choose a comparable index.

3. Capitalization – If I have elected the "Full Deferral" repayment option (the applicable repayment option is stated on the first page of this Application/Promissory Note), I am not obligated to make any payments until the loan enters the Repayment Period. You will add unpaid accrued interest to the principal loan balance as of the last day of each calendar quarter (the last day of December, March, June and September) during the Deferment Period and at the end of my Deferment Period. Interest that is added to principal is called "Capitalized" interest. Capitalized interest will be treated as principal. In addition, if I am in default and the loan has been sold to TERI (see Section L.12), TERI may capitalize accrued and unpaid interest as of the date it purchases my loan. I understand that you will add all accrued and unpaid interest to the principal balance of my loan on the last day of the Deferment Period and at the end of any forbearance period.

E. TERMS OF REPAYMENT:

1. Deferment Period – If I have elected either the "Interest Only" repayment option or the "Full Deferral" repayment option (the applicable repayment option is stated on the first page of this Application/Promissory Note), you will send me statements during the Deferment Period (showing the total outstanding principal balance of my loan and the interest that has accrued on my loan). Statements will be sent to the address shown on your records. If I have elected the "Interest Only" repayment option, I agree to make payments each month during the Deferment Period equal to the accrued interest on the outstanding balance of this Application/Promissory Note. If I have elected the "Full Deferral" repayment option I may, but am not required to make payments during the Deferment Period. You will add any interest that I do not pay during the Deferment Period to the principal balance, as described in Paragraph D.3.

2. Repayment Period – During the Repayment Period, you will send me monthly statements or a coupon book which shows the amounts of minimum monthly payments and the payment due dates. You reserve the right to send monthly statements or coupon books to either the Borrower or the Cosigner. I will make consecutive monthly payments in amounts at least equal to such minimum monthly payments by the applicable payment due dates until I have paid all of the principal and interest and any other charges I may owe under this Application/Promissory Note.

3. Repayment Terms – My monthly payment will be established based on the rules in this Application/Promissory Note when my Repayment Period begins. My monthly payment amount will be calculated as of the day the Repayment Period begins ("Repayment Date"). It will also be calculated following any subsequent deferment or forbearance period or any request by the Borrower to the servicer to change the monthly payment due date (each of which events is a new "Repayment Date"). After any Repayment Date is set, my monthly payment will be recalculated once each year prior to the anniversary of the Repayment Date. My new monthly payment amount, which will take effect on the anniversary of the Repayment Date, will be disclosed to me each year by the servicer. The new monthly payment amount will equal the amount necessary to pay in full, over the number of months remaining in the Repayment Period, the amount I owe in equal monthly installments of principal and interest at the Variable Rate in effect at the time of the calculation. I understand that this may result in a reduction or increase in my monthly payment as calculated each year. I understand that during the Repayment Period (and, if I have elected the "Interest Only" repayment option, during the period of monthly interest payments) the servicer may change the monthly payment due date of future payments to a later date for the convenience of the servicer in processing payments or in order to coordinate the due dates of all of my loans processed by the servicer. This change in monthly payment due date may result in the charging of additional interest in the month of the change, which I agree to pay.

4. Minimum Repayment – During the Repayment Period, my minimum payment will be at least \$25 each month or the entire unpaid loan balance, whichever is less. I understand that I may pay more than my monthly payment at any time without penalty or charge.

5. Amounts Owed at the End of the Repayment Period – Since interest accrues daily upon the unpaid principal balance of my loan, if I make payments after my payment due dates, I may owe additional principal, interest, and/or late charges at the end of

the Repayment Period. If I have not paid my late charges, I will also owe additional amounts for those late charges. In such cases you will increase the amount of my last monthly payment to the amount necessary to repay my loan in full in a single payment.

6. **Payments** – Payments will be applied first to late charges and other fees and charges, then accrued interest, and the remainder to principal. If I have multiple loans processed by the servicer, and I submit a single payment that is not sufficient to pay all of the amounts I owe, such payment will be divided between or among the loans in accordance with applicable law and the servicer's customary procedures.

7. **Other Charges** - If any part of a monthly payment remains unpaid for a period of more than 15 days after the payment due date, I will pay a late charge not exceeding \$5.00 or 5% of the overdue payment amount, whichever is less. I will pay only one late charge for any payment, regardless of the number of days it is late. To the extent permitted by law, I agree to pay you all amounts you incur in enforcing the terms of this Application/Promissory Note, including reasonable collection agency and attorney's fees and court costs and other collection costs.

F. **LOAN ORIGINATION FEE:** You may charge me an Origination Fee. If you charge me, at the time you issue any disbursement to me, or on my behalf, you may add the Origination Fee to my loan amount. The dollar amount of any Loan Origination Fee will be determined by multiplying the sum of the Loan Origination Fee and the Loan Amount Requested, to the extent advanced to me, times the Loan Origination Fee Percentage shown on the first page of this Application/Promissory Note. The percentage would be higher if computed only on the amount advanced rather than the entire principal amount (Loan Origination Fee plus Loan Amount Requested). For example, a nominal Loan Origination Fee of 6.5% on the entire principal amount would equal 6.9519% of the amount advanced. The Loan Origination Fee I will pay, if any, will be shown on my Disclosure Statement and will be added to the principal amount of my loan. To the extent permitted by law, and unless I timely cancel this

Application/Promissory Note (see Paragraph B.3), I will not be entitled to a refund of any Loan Origination Fee after my Disbursement Check has been negotiated.

G. **RIGHT TO PREPAY:** I have the right to prepay all or any part of my loan at any time without penalty or charge.

H. **FORBEARANCE:** If I am unable to repay my loan in accordance with the terms established under this Application/Promissory Note, I may request that you modify these terms. I understand that such modification would be at your option. I understand that I will remain responsible for all interest accruing during any period of forbearance and that you will add any interest that I do not pay during any forbearance period to the principal balance, as described in Paragraph D.3.

I. **WHOLE LOAN DUE:** To the extent permitted by applicable law, I will be in default if: (1) I fail to make any monthly payment to you when due, (2) I die, (3) I break any of my other promises in this Application/Promissory Note, (4) Any bankruptcy proceeding is begun by or against me, or I assign any of my assets for the benefits of my creditors, or (5) I make any false written statement in applying for this loan or at any time during the Deferment or Repayment Periods. I understand that if I default on my loan, disclosure of my loan information to consumer reporting agencies may adversely affect my credit rating. If I default, I will be required to pay interest on this loan accruing after default. The interest rate after default will be subject to adjustment in the same manner as before default. To the extent permitted by law, upon default, you will have the right to give me notice that all amounts outstanding under this

Application/Promissory Note are due and payable at once. Upon default, you may also capitalize any interest and fees (i.e., add accrued and unpaid interest and fees to the principal balance), and increase the Margin used to compute the Variable Rate by two percentage points (2%).

J. NOTICES:

1. I will send written notice to the servicer authorized by you to service my loan account, or any subsequent holder of this Application/Promissory Note, within ten days after any change in my name, address, or enrollment status at the School. I will send any notice that I give under this Application/Promissory Note to the servicer authorized by you to service my loan account, to the address you provide.

2. Any notice required to be given to me by you will be effective when mailed by first class mail to the latest address you have for me. Unless required by applicable law, you need not give a separate notice to the Cosigner, if any.

K. INFORMATION:

1. I must update any and all information related to this Application/Promissory Note or my loan application whenever you ask me to do so.

2. I authorize you from time to time to request and receive from others credit related information about me (and about my spouse if I live in a community property state).

L. ADDITIONAL AGREEMENTS:

1. I understand that you are located in OHIO and that this Application/Promissory Note will be entered into in the same state. CONSEQUENTLY, THE PROVISIONS OF THIS APPLICATION/PROMISSORY NOTE WILL BE GOVERNED BY FEDERAL LAW AND THE LAWS OF THE STATE OF OHIO, WITHOUT REGARD TO CONFLICT OF LAW RULES.

2. The proceeds of this loan will be used only for my educational expenses at the School. The Cosigner will not receive any of the loan proceeds.

3. My responsibility for paying the loan evidenced by this Application/Promissory Note is unaffected by the liability of any other person to me or by your failure to notify me that a required payment has not been made. Without losing any of your rights under this Application/Promissory Note you may accept (a) late payments, (b) partial payments or (c) payments marked "paid in full" or with other restrictions. You may delay, fail to exercise, or waive any of your rights on any occasion without losing your

entitlement to exercise the right at any future time, or on any future occasion. You will not be obligated to make any demand upon me, send me any notice, present this Application/Promissory Note to me for payment or make protest of non-payment to me before suing to collect on this Application/Promissory Note if I am in default, and to the extent permitted by applicable law, I hereby waive any right I might otherwise have to require such actions. I WILL NOT SEND YOU PAYMENTS MARKED "PAID IN FULL", "WITHOUT RECOURSE" OR WITH OTHER SIMILAR LANGUAGE UNLESS THOSE PAYMENTS ARE MARKED FOR SPECIAL HANDLING AND SENT TO THE ADDRESS IDENTIFIED FOR SUCH PAYMENTS ON MY BILLING STATEMENT, OR TO SUCH OTHER ADDRESS AS I MAY BE GIVEN IN THE FUTURE.

4. I may not assign this Application/Promissory Note or any of its benefits or obligations. You may assign this Application/Promissory Note at any time.

5. The terms and conditions set forth in this Application/Promissory Note and Instructions and the Disclosure Statement constitute the entire agreement between you and me.

6. If any provision of this Application/Promissory Note is held invalid or unenforceable, that provision shall be considered omitted from this Application/Promissory Note without affecting the validity or enforceability of the remainder of this Application/Promissory Note.

7. A provision of this Application/Promissory Note may only be modified if jointly agreed upon in writing by you and me. Any modification will not affect the validity or enforceability of the remainder of this Application/Promissory Note. If I fax my Application/Promissory Note, I have read and understand the prohibition regarding changes in Paragraph L.16.

8. To the extent permitted by law, you have the right to apply money from any of my deposit account(s) with you to pay all or a portion of any amount overdue under this Application/Promissory Note. If I am in default at any time (including but not limited to a situation where I give an improper cancellation notice), you may exercise on my behalf any right that I may have to cancel my enrollment at the School and receive a full or partial refund of payments made to the School. I authorize the School to pay any or all of such amounts directly to you upon receipt of notice from you that I am in default under this Application/Promissory Note, and I give you a security interest in all such amounts.

9. If this Application/Promissory Note is executed by more than one Borrower, any notice or communication between you and any of the Borrowers will be binding on all of the Borrowers. Each Borrower intends to be treated as a principal on this Application/Promissory Note and not as a surety. To the extent any Borrower may be treated as a surety, such Borrower waives all notices to which such Borrower might otherwise be entitled as such by law, and all suretyship defenses that might be available to such Borrower (including, without limitation, contribution, subrogation and exoneration). Each Borrower agrees that any Borrower may agree to any forbearance or other modification of the repayment schedule and that such agreement will be binding on each Borrower. It shall not be necessary for you to resort to or exhaust your remedies against any Borrower before calling upon any other Borrower to make repayment.

10. All dollar amounts stated in this Application/Promissory Note are in United States dollars. I will make all payments in United States Dollars with no deduction for currency exchange.

11. The Student's failure to complete the education program paid for with this loan will not relieve any Borrower of any obligation under this Application/Promissory Note.

12. I acknowledge that the requested loan may be subject to the limitations on dischargeability in bankruptcy contained in Section 523 (a) (8) of the United States Bankruptcy Code. Specifically, I understand that you have purchased a guaranty of this loan, and that this loan is guaranteed by The Education Resources Institute, Inc. ("TERI"), a non-profit loan guaranty agency.

13. I authorize any School that I may attend to release to you, and any other persons designated by you, any requested information pertinent to this loan (e.g., enrollment status, prior loan history, and current address).

14. I authorize the Lender, any subsequent holder of this Application/Promissory Note, and their agents to: (1) advise the School of the status of my application and my loan, (2) respond to inquiries from prior or subsequent lenders or holders with respect to my Application/Promissory Note and related documents, (3) release information and make inquiries to the persons I have given you as references, for the purposes of learning my current address and telephone number, (4) check my credit and employment history and to answer questions about their credit experience with me, and (5) disclose to TERI, the Borrower, and/or the Cosigner either in connection with this transaction or any future transaction all information (including status information and non-public personal information) of the Borrower and/or the Cosigner provided in connection with this Application/Promissory Note.

15. Waiver by Lender: Except as stated in Paragraph L.8, you waive (give up) any right to claim a security interest in any property to secure this Application/Promissory Note. This does not affect any right to offset as a matter of law.

16. If I fax my signature(s) on the first page of this Application/Promissory Note back to you and keep the copy I signed, I understand that under federal law the fax you receive will be an original of the first page of this Application/Promissory Note and I will refax the first page upon request by Lender. I may NOT amend the Application/Promissory Note by making changes to the Signature Page, which are then faxed to Lender. If the Borrower faxes the Signature Page, and the Lender approves the application, then there will be two originals of the Agreement: the Lender's copy and the Borrower's copy.