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"Increasing Student Aid Through Loan Reform"

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Mr. Chairman, Ranking Member McKeon, and members of the Committee, my name is Chris Chapman and I am the President and CEO of Access Group, a Delaware-based, national nonprofit student loan provider. During my career, I worked for several other nonprofit student loan entities---immediately prior to my current position, I served as President and Chief Executive Officer of ALL Student Loan Corporation, a nonprofit loan provider based in Los Angeles, California. I might also note that my career began as a staff member for a long-time House Democrat from Ohio named Tom Luken. Thank you for inviting me to come before you today and for holding a hearing to discuss the issue of student loan reform.

Access Group is a nonprofit student loan provider with over 25 years experience specializing in federal financial aid and graduate and professional student loans. Student loans are our only business. We originate more than $1 billion of FFELP loans annually and currently hold more than $6 billion of FFELP loans. Moreover to support and maximize our charitable mission to enhance access to higher education, we conduct outreach and educational programs that support students, parents, school administrators and other interested constituencies. Our in-person sessions that range from information about financing an education, to understanding and maintaining your credit score, to life after graduation, are supported by a panoply of free educational material, available online and in print.

It may sound cliché that as a nonprofit entity we are free to focus on "stakeholders" rather than "shareholders". But it's true. Furthermore, as a board member of the Education Finance Council – the national trade group for nonprofit student loan providers – I can tell you that this outlook and sense of mission is broadly shared by the three dozen nonprofit student lenders based in states all across our Nation. These entities have historically and consistently channeled loan revenue back into the program in the form of discounted student loan rates, origination fee waivers, and the implementation of college outreach and access efforts. This is because the question that each of their management teams and boards of directors must face every day is "how do we help more Americans achieve their higher education dreams?" rather than "how do we maximize shareholder return?" This is not a value judgment, and should not be interpreted as an indictment of for-profit entities—but, rather, it should be construed as the

core basis for the distinction and importance of nonprofit loan providers in supporting the policy goals of a strong and diverse student loan program.

I think I speak for *all* FFELP lenders in expressing thanks to this committee for drafting last spring the Ensuring Continued Access to Student Loans (ECASLA) legislation that has maintained the ability of all eligible students to get a FFELP loan during the 2008-09 academic year – and for extending the legislation through the upcoming 2009-10 academic year. Access Group has financed more than $800 million of new FFELP loans for the 2008-09 academic year through the participation interest facility created by the Department of Education under the ECASLA authority. We are also among the first issuers to finance student loans through the student loan asset-backed commercial paper conduit, also created under ECASLA.

I intend to focus in my testimony today on the commercial paper conduit facility, and its potential implications for the future of student loan finance.

As mentioned earlier, just last week, Access Group became one of the initial lenders to issue commercial paper backed by loans financed through the conduit. $1 billion in commercial paper was issued on May 11, of which $250 million was backed by Access Group loans. This successful funding was the culmination of months of shared effort put forth by members of the last Administration, members of the current Administration, and a number of private-sector entities
I was a member of the initial conduit advisory board, which was created when the conduit was first being structured late last year, and I have continued as one of the five members of the advisory committee overseeing the implementation of the facility. I feel there are lessons to be learned from this effort that suggest a positive path forward for federal student lending and a way to keep private capital involved in the federal student loan program. This path could enable the Administration, the Congress and student loan providers to achieve the widely-shared objective of making available increased private funding for federal student aid at no additional budgetary cost. And it would simultaneously allow for the retention of the key virtues of the current FFELP, such as the maintenance of a diverse array of originators, servicers and financers of federal student loans, and the choice, competition, flexibility and service that only such diversity can deliver.

As you are aware, ECASLA was enacted to address an environment in which the yield on FFELP loans was set at an all time-low and the financing costs had reached unprecedented highs due to the broad-based seizure of the credit markets. Student loans played no part in the creation of the financial crisis, but the capital markets effectively shut down, leaving lenders unable to finance new loans beyond already committed capital.

Based on its initial performance, it appears that the conduit has been successfully structured to persuade investors to purchase student loan assets at yields similar to those that existed *prior* to the severe credit market downturn.

This indicates that is possible to finance *new* FFELP originations -- even at the existing low statutory yield and the current extremely abnormal capital market environment -- so long as there is federal liquidity support involved.

Of course, no discussion of federal student loan policy and the associated programs that support a given policy is complete without considering their budgetary impact.

Direct lending scores large federal budget savings because – at least the way the program is scored – it allows the loans to be financed at Treasury bond rates. For instance, the Office of Management and Budget assumes that direct loans originated in Fiscal Year 2010 will be financed by Treasury notes yielding a weighted average of 2.8-percent. The most common borrower rate on these loans will be 6.8 percent, creating a 400-basis point spread for the Government. This works as long as long-term Treasury borrowing rates remain low – and as long as scorekeepers continue to omit consideration of the increased government-wide economic cost of that additional Treasury borrowing on the scale required to directly finance all federally-backed loans will bring. The *Analytical Perspectives* volume of the budget projects Government federal direct loan accounts (the largest of which is the direct student loan program) to grow from nearly $200 billion in 2008 to $1.6 Trillion in 2019. Presumably, most of this $1.4 Trillion increase in the loan-backed public debt is attributable to the projected expansion of the direct student loan program.

The conduit also can reduce program cost by leveraging Treasury support, but in this case the support comes not from leveraging Treasury borrowing directly, but rather from leveraging the Treasury's liquidity strength. The advantage of using only the liquidity support is that it would prevent the necessity of borrowing roughly $100 billion a year to finance all new student loan originations. Under the conduit – or any other liquidity "backstop" – the Government only needs to actually step in and finance loans when the conduit is unable to refinance maturing commercial paper—an event made extremely unlikely even in financial crises due to the existence of the backstop itself. This allows for a reduction in student loan financing costs that would simultaneously produce revenue to the Government. In short, the Administration's recommendation of leveraging Treasury support could be implemented in a manner that also leverages private capital.

On May 7, the Administration released its detailed FY 2010 *Budget Appendix*, which shows that student loans subject to the various ECASLA programs created by the Department of Education are projected to perform at a level much better than the "budget neutrality" required by ECASLA. Rather, they are projected to generate more than $8 billion in income for the Treasury. The conduit alone is projected in the budget to generate $1.4 billion in net revenue from $25 billion in student loan volume – even after including life of loan administrative expenses. This revenue is generally from fee income, since participants pay 25 bps as a

fixed liquidity fee and 5 bps (escalating to 25 bps over time as a fixed put fee. The actual savings could increase significantly beyond this projected total, as demand for the program increases and investors accept lower yields as more comfort with the program is achieved. This is because the Government captures 80-percent of the benefit if the financing cost sets below a specified target rate. So there is a significant additional upside potential to the Government, but virtually no downside. There is little downside because the expected conduit revenue included in the budget numbers is essentially fully collateralized fee income, which makes it more predictable and reliable than projected savings from the direct loan program – which are highly dependent on future interest rate projections.

To illustrate the peril in projecting future interest rates, we need only to look to past student loan program projections. Indeed, according to the re-estimate chart in the President's *Budget Appendix* the actual cost of the $250 billion in direct loans disbursed since the program was created is nearly 20 times higher than original estimates -- $11.7 billion, rather than $600 million. Another way of looking at this is that direct loans when issued were scored as costing a fifth of a penny per dollar loaned out, but those same loans are now projected to cost close to five cents per dollar loaned. FFELP loans, in contrast, cumulatively cost $12.5 billion *less* than original projections. If this pattern were to hold going forward, the actual savings from a transition to 100-percent Treasury-financed student lending would save only a fraction of what scorekeepers currently project.

In sum, the most recent budgetary data demonstrates that policy makers have a range of options available and considerations to take into account in pursuing the objective of increasing student aid spending through student loan reform.

I will point out that the conduit as it stands is not financing nirvana for every student loan provider—especially nonprofit providers. While Access Group and several other nonprofit providers are able to utilize the facility effectively, its one-size-fits-all nature necessarily limits its accessibility for many. But this need not be the case going forward. More portable and flexible versions of the conduit could be created, operating under the same fundamental principle of federal liquidity support, provided in order to make possible low-cost capital for financing student loans, with lenders paying a fee(s) that generates revenue for the Government.

Along these lines, it is worth noting that the House Financial Services Committee majority just last week posted on its website draft legislation -- the "Municipal Market Liquidity Enhancement Act of 2009" -- authorizing the Federal Reserve to establish new, federally-supported liquidity facilities for the financing of certain municipal securities. That bill seems to clearly envision an array of liquidity facilities that need not conform to one specific format.

There obviously needs to be some exploration of potential facilities, and how they could be best structured to encourage lender participation while generating projected budgetary revenue. The practical example of the existing student loan conduit, however, provides a useful new precedent that gives policymakers actual experience and data with which to work.

Federal fiscal considerations aside, the bottom line consideration should be that, from the borrower and school standpoint, there is tremendous value in a system that enables a diverse array of student loan providers to continue to finance, originate and service federal student loans in a manner that maintains the long-standing, productive partnerships forged over time. Avoiding the massive job displacement and loss of experienced borrower support personnel that would arise from an uprooting of these partnerships should be a goal of any student loan reform effort.

Students have benefited from having their choice of student loan provider and from all of the services provided by the FFELP community. I urge the committee to explore the use of federal liquidity support structures as an avenue for creating savings for student aid that preserves the best elements of the current student loan program.