JOINT HEARING ON THE

STUDENT LOAN DEBT CRISIS

BACKGROUND PAPER

Assembly Select Committee on Youth and California's Future
and the
Assembly Banking and Finance Committee

August 29, 2017

ABOUT THE HEARING

On August 29, 2017, the California State Assembly Select Committee on Youth and California's Future and the Assembly Committee on Banking and Finance will convene a joint hearing focused on the current state of student loans in California. Experts will provide an overview of the student loan crisis and student loan terminology, outline current regulations on student loans, analyze current trends in student loan debt in the United States and in California, and discuss state-based policy solutions on how the state and servicers can better support students to decrease default rates on student loans.

This background paper provides a basic introduction to the student loan crisis, examines long-term implications of student loan debt, reviews common student loan repayment terms, and discusses the impacts of default on borrowers. The information below will be supplemented by handouts and testimony provided by invited witnesses.

INTRODUCTION

Student loans are the second largest component of United States household debt, second only to mortgages. According to the Federal Reserve Bank of New York, 44 million Americans collectively owed $1.4 trillion in outstanding student loan debt as of June 2017.[1] This amounts to a stunning 159% increase since 2007.[2]

According to a 2014 report by the Institute for College Access and Success, 55% of students attending public and private four-year colleges and universities in California took out loans.[3] The average debt upon graduation was $21,382, compared to $16,071 in 2004. This represents a 33% percent increase in average debt over a ten-year time frame.

Of the 43 million Americans with student debt, 16% are in long-term default —a potential hit in excess of $100 billion that taxpayers would absorb. In 2013, according to the Department of Education, three-year cohort default rates were 21.8% at for-profit colleges, 13.6% at public colleges, and 8.2% at private, non-profit colleges.[4]

STUDENT LOAN DEBT CRISIS IMPLICATIONS

While other types of debt, including credit card and mortgage debt, fell in the aftermath of the Great Recession, student loan debt increased sharply—the result of more people taking out student loans and of people borrowing more money.[5]

Four key changes help us understand why debt has risen so quickly in recent years:[6]

1. Federal aid policies expanded loan eligibility and shifted from grants to loans.

2. More students are participating in college; enrollment has grown by 5 million over the past decade.

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[1] https://www.federalreserve.gov/releases/g19/current/default.htm
[2] https://www.bostonglobe.com/metro/2016/05/18/student-loan-debt-has-tripled-trillion-yes-trillion/JwnmJ1uCkSchgbAN4CDlzJ/story.html
[3] http://ticas.org/posd/map-state-data#overlay=posd/state_data/2016/ca
[4] https://www.ed.gov/news/press-releases/default-rates-continue-rise-federal-student-loans
[5] http://www.urban.org/sites/default/files/publication/23736/412849-Forever-in-Your-Debt-Who-Has-Student-Loan-Debt-and-Who-s-Worried-.PDF
[6] http://publications.nasfaa.org/cgi/viewcontent.cgi?article=1588&context=jsfa

3. States have divested public support and shifted the financial burden onto students via higher tuition charges.
4. Median family incomes have fallen each year since 2005, making it more difficult for students to pay the rising price of college out of savings or work income.

Excessive student loan debt is crippling for our economy and impacts financial decision for years after one attends an institution of higher education. A growing body of research suggests that student debt burden limits borrowers' access to credit, diminishes savings, reduces homeownership, threatens retirement security, and inhibits borrowers from pursuing careers as healthcare providers and educators in underserved communities, small-business owners, or as entrepreneurs.[7][8]

Education debt has become a drag on the kinds of spending and saving that historically helped U.S. economic growth. The average college-educated head of household under 40 owes $404 a month in student debt payments, according to an AP analysis of Federal Reserve data.[9] That is slightly more than what the government says the average college-educated family spends at the supermarket.

More disturbingly, studies show student debt payments lead to a decline in college savings for the borrowers' children — creating a multigenerational debt cycle.[10] The bottom line is decisions students are making to fund college for a short amount of time have long term implications that affect not only the individual, but our economy as a whole.

STUDENT LOAN REPAYMENT

There are four main types of postsecondary education loans under which borrowers have outstanding balances:[11]

Type	Description	Total Amount, 2016
Direct Loan	Made directly to borrowers by the United States Department of Education	$949 billion
Federal Family Education Loan Program	Originated by private lenders and guaranteed by the federal government until 2010, new FFEL loans have ceased	$335 billion
Federal Perkin Loan	Co-funded by institution of higher education and government, are originated and administered by participating educational institutions	$8 billion
Private Student Loan	Made by depository and non-depository financial institutions, institutions of higher education, and other entities	$103 billion

[7] http://www.asa.org/site/assets/files/4743/life_delayed_whitepaper_2015.pdf
[8] http://files.consumerfinance.gov/f/201509_cfpb_student-loan-servicing-report.pdf
[9] https://www.usnews.com/news/politics/articles/2016-09-05/why-it-matters-student-debt
[10] https://www.usnews.com/news/politics/articles/2016-09-05/why-it-matters-student-debt
[11] http://sbnk.senate.ca.gov/sites/sbnk.senate.ca.gov/files/StudentLoanBackgrounder.PDF

Each main loan type includes several different subtypes, depending on whether the borrower is a student or a parent; whether the borrower can prove financial need; whether the money is to be used for undergraduate, graduate or professional degree program; and when the loan is made. Private student loans contain even more variability than federal loans, because each private lender is able to offer its own individualized loan product.[12]

The wide array of student loan products can become confusing when the time comes to begin repaying those loans.[13] Some loans require borrowers to begin repayment immediately; others allow borrowers to wait for specified periods of time before repayment must begin. Some loans offer borrowers income-based repayment plans (of which there are multiple options); others do not. Some student loan debt is eligible for forgiveness after a period of time, if certain conditions are met; other loan debt is not.

STUDENT LOAN SERVICING

Although the Department of Education initially administers a vast-majority of all student loans, borrowers repay Federal loans to loan servicers. A loan servicer is a company that handles the billing and other services for federal student loans.[14] Servicers manage borrowers' accounts, process monthly payments, manage enrollment in alternative repayment plans, and communicate directly with borrowers. There are no consistent, market-wide federal standards for student loan servicing. Servicers generally have discretion to determine policies related to many aspects of servicing operations.[15]

According to the most recent published data, eight loan servicers have contracts with the Department of Education with individual portfolios ranging from 4% to 16% of student loans. The three largest servicers are the Higher Education Loan Authority of the State of California, Cornerstone, and Great Lakes.

Experts will detail complaints against student loan servicers' behavior including lack of transparency about repayment options and processing errors. Additionally, experts will outline recent legal actions against loan servicers.

STUDENT LOAN DEFAULT

Student loan repayment becomes especially difficult when a student defaults on their loans.

Prior to default, a loan becomes delinquent the first day after a missed payment.[16] If a loan continues to be delinquent, the loan may go into default. The point when a loan is considered to be in default varies depending on the type of loan you received. For a large majority of loans, a borrower is considered to be in default if they make no scheduled student loan payments for a period of at least 270 days (about nine months).[17]

Default is a devastating reality for eight million borrowers who have given up on paying more than $137 billion dollars in educational debt[18]. According to The Institute for College Access and

[12] ibid.
[13] ibid.
[14] https://studentaid.ed.gov/sa/repay-loans/understand/servicers
[15] http://files.consumerfinance.gov/f/201509_cfpb_student-loan-servicing-report.pdf
[16] https://studentaid.ed.gov/sa/repay-loans/default#default
[17] ibid.
[18] http://time.com/money/4701506/student-loan-defaults-record-2016/

Success, one out of every six people who have any federal student debt have not made a payment on their loans for at least nine months.

The consequences of default are staggering and life altering, including the following:[19]

- The entire unpaid balance of your loan and any interest you owe become immediately due (this is called "acceleration").
- You can no longer receive deferment or forbearance, and you lose eligibility for other benefits, such as the ability to choose a repayment plan.
- You will lose eligibility for additional federal student aid.
- The default will be reported to credit bureaus, damaging your credit rating and affecting your ability to buy a car or house or to get a credit card.
- Your tax refunds and federal benefit payments may be withheld and applied toward repayment of your defaulted loan (this is called "Treasury offset").
- Your wages will be garnished. This means your employer may be required to withhold a portion of your pay and send it to your loan holder to repay your defaulted loan.
- You may not be able to purchase or sell assets such as real estate.
- It may take years to reestablish a good credit record.

RECENT ACTIONS

In 2016, Assemblymember Mark Stone authored the California Servicing Act requiring student loan servicers to obtain a license from the Commissioner of Business Oversight if they are located in California or if they are servicing loans made to California residents.[20] The full act will take effect on July 1, 2018. It will be important to track implementation and outcomes from licensure when the program is fully instituted.

In January 2017, the Consumer Finance Protection Bureau sued the largest student loan servicer, Navient, alleging systematic and illegal failure to borrowers at every stage of repayment, including: [21]

- Failing to correctly apply or allocate borrower payments to their accounts.
- Obscuring information consumers needed to maintain their lower payments.
- Harming the credit of disabled borrowers, including severely injured veterans.

Litigation is ongoing and could take years to resolve "because of the sheer amount of evidence" that CFPB has collected during its investigation.[22]

[19] https://studentaid.ed.gov/sa/repay-loans/default#default
[20] https://www.acainternational.org/news/california-enacts-student-loan-servicer-licensing-requirement
[21] https://www.consumerfinance.gov/about-us/newsroom/cfpb-sues-nations-largest-student-loan-company-navient-failing-borrowers-every-stage-repayment/
[22] https://www.nerdwallet.com/blog/loans/student-loans/navient-student-loan-lawsuit/

LOOKING TO THE FUTURE

United States Secretary of Education Betsy DeVos, upon taking control of the United States Department of Education (U.S. DOE), indicated California policy makers may need to take decisive steps to protect students.

In June 2017, the U.S. DOE froze Obama-era regulations erasing the federal loan debt of student borrowers who were cheated by colleges that acted fraudulently. Following this action, California Attorney General Becerra joined seventeen other states in suing the department.[23] Additionally, the U.S. DOE indicated uncertainty for programs previously created to aid consumers struggling to repay debt including Public Service Loan Repayment and Income Based Repayment.

With an unknown future, California policy makers should develop state-based policy solutions to protect students from crippling student debt and limit student loan debt defaults by regulating servicers to be more responsive and transparent to consumers.

[23] https://oag.ca.gov/news/press-releases/attorney-general-becerra-sues-us-department-education-unlawfully-delaying