Private Student Loan Report: Guide to Updates

On July 19, the CFPB and the Department of Education ("The Agencies") published a Report on Private Student Loans. That Report included an analysis of several datasets, including data submitted by nine Sample Lenders on the over 5.4 million private student loans made by those lenders between 2005 and 2011. Today, the CFPB and the Department of Education are issuing an update. Please refer to this guide for a summary of updates.

Following the initial publication of the Report, the Sample Lenders notified the Agencies that relying on the data field "program type" in the data set they provided (i.e. undergraduate, graduate, medical, law, or certificate/continuing) could produce incomplete results. Other industry observers also made inquiries about the extent of exhaustion of federal Stafford Loans by private student loan borrowers. Based on this feedback, we felt it would be helpful to publish updates to these measures. The updates do not impact the Report's conclusions or policy recommendations. Additionally, we are also presenting a separate log of corrections of typographical errors in the original Report.

In the Report, the Agencies used program type as a necessary variable to produce a series of analyses on the data from the Sample Lender loan level data submission. These analyses are reflected in Figures 6, 7, and 13 and the associated text in the body of the Report as well as Appendix Figures 1, 2, 3, and 5 in Data Appendix II. To clarify, the affected analyses only involve Sample Lender loan level data that was sorted by program type. Aggregate Sample Lender loan level data analyses are unaffected, as well as analyses of Sample Lender portfolio data and other datasets.

Narrative Account of Rationale for Updates and Impact on Recommendations

In the original analysis the Agencies reported certain characteristics of loans that contained a valid entry in the "program type" data field. Our original analysis of the loans with a valid program type was an accurate reflection of the characteristics of those loans; however, after consultation with the third party data manager and upon further review the Agencies concluded that the incidence of a valid program type entry was not randomly distributed with respect to the other loan characteristics. Loans that included a valid "program type" field showed wide variation in school certification across the study period, dipping to below 30% in 2009 while loans that did not include a valid "program type" field were primarily school certified. Loans without a valid program type field represented approximately 60% of the entries in the overall data submission. Thus, while our original analysis produced results that were accurate with respect to the records analyzed, the analysis understated the scope of school certification of the loans originated by the Sample Lenders to undergraduates.

The Agencies have developed a supplemental method of creating a proxy for "program type" from other data fields such as "years in school" and "course of study." This proxy methodology was developed with consultation with the independent third-party data manager who was retained by the lenders to collect, harmonize, and de-identify the data submission. Using this proxy methodology, the Agencies generated revised versions of Figures 6, 7, and 13 in the body of the report as well as Appendix Figures 1, 2, 3 and 5 in Data Appendix II.

In addition, the Agencies have added a new Figure, 7A, that more clearly illustrates the close relationship between direct-to-consumer ("DTC") lending and elevated levels of borrowing. This close relationship informed the policy recommendation in the initial report of mandatory school certification of financial need prior to approval of a private student loan.

While original Figure 7 and revised Figure 7 show the mean ratio for school certified and DTC loans combined, Figure 7A shows the median ratio for the loans split by certification status. After further examination of the shape of the frequency distribution of the data and consultation with the lenders' data manager, we chose to use the median instead of the mean in Figure 7A. The distribution includes some borrowers with a very high ratio, making the median a more useful measure of typical borrowing behavior. With the additional perspective provided by Figure 7A, the relationship between DTC lending and elevated levels of borrowing becomes clearer. There is a substantial difference in the level of borrowing relative to tuition costs between the school certified and DTC channels. Additionally, while the median school certified ratio of loan amount to tuition and fees stayed relatively stable over time, the same ratio for DTC loans peaked at nearly 150% in the 2005 – 2006 academic year and then steadily declined to less than 90% in 2011. This decline in the level of borrowing in the DTC channel after the closing of the securitization market suggests that lenders have the ability to modulate the level of borrowing within that channel in response to market and other signals.

In the report, the Agencies found that a substantial number of private student loan borrowers did not exhaust their Stafford Loan options under Title IV of the Higher Education Act. We reported that 40% of PSL borrowers who also obtained a Stafford Loan did not exhaust the total amount of Stafford loans for which they were eligible. It is important to note that many other PSL borrowers took out no Stafford Loans at all. When we include borrowers who chose to borrow $0 in Stafford Loans (whether or not they applied for federal financial aid or not), the proportion of students who borrowed a private student loan but did not borrow their individual Stafford loan maximum rises to 54.5%.

The revised analysis supports the original recommendations found in the Report. The most material change to the Report's conclusions as a result of these revisions is the finding in the Amended Report, illustrated in Amended Figure 6, that during the boom period, the prevalence of direct-to-consumer lending was significant, though less widespread within the data submission than the Report had originally concluded. Despite finding a lower overall penetration of DTC borrowing during the lending boom period, the revised analysis, highlighted by Figure 7A, still finds a close relationship between DTC borrowing and higher levels of borrowing, relative to tuition and fees. In other words, while the frequency of DTC borrowing is lower than we had previously concluded, the risk of consumer harm in DTC lending programs is unchanged from our original analysis. The magnitude of this finding is illustrated in new Figure 7A, showing that median DTC private loan amounts as a percentage of tuition and fees peaked at 151% in academic year 2006-2007 as compared to 55% for school-certified loans. This outsized level of private loan borrowing leads to elevated risk for consumers and lenders alike. Thus, while the more recent decline in the borrowing rate for DTC loans suggests, as noted, that lenders can modulate the level of borrowing in the DTC channel, the fact that DTC loans were not modulated during the boom years means that the rationale for recommending mandatory school certification of financial need before a private loan is approved or disbursed is not affected by the amendments or updates to the Report.

Log of Amendments Related to Program Type Data Robustness Issue:

1. Executive Summary, p. 3.

   Original Sentence, "From 2005 – 2007, lenders increasingly marketed and disbursed loans directly to students, reducing the involvement of schools in the process; indeed during this period, the percentage of loans to undergraduates made without school involvement or certification of need grew from 40% to over 70%."

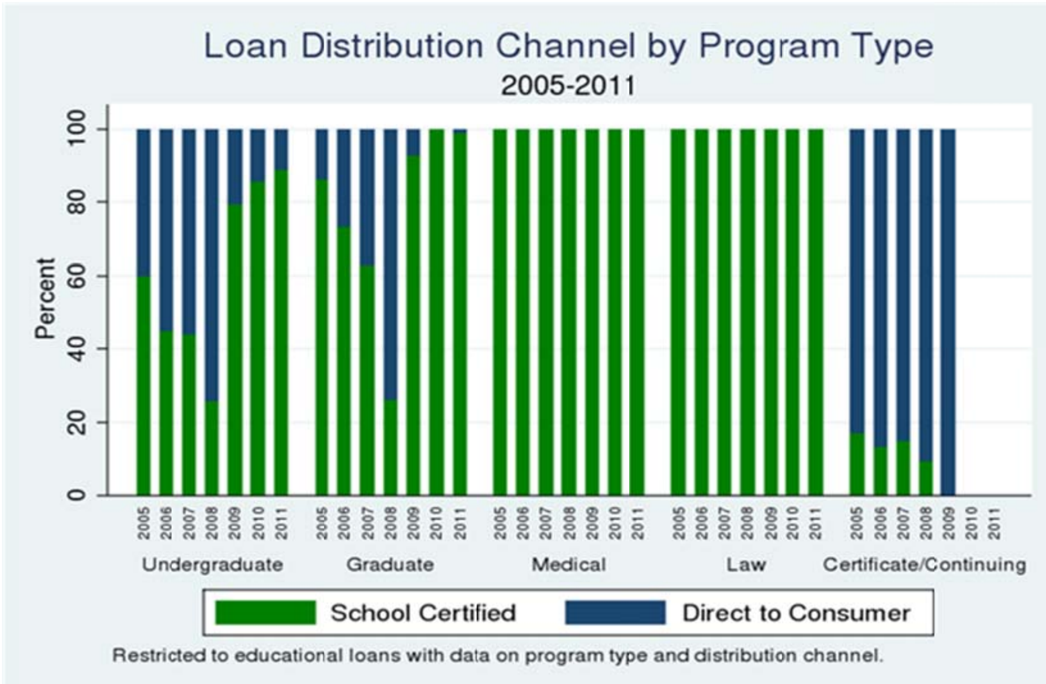
   Amended Sentence, "From 2005 – 2007, lenders increasingly marketed and disbursed loans directly to students, reducing the involvement of schools in the process; indeed during this period, the percentage of loans to undergraduates made without school involvement or certification of need grew from 18% to over 31%."
2. Part One, p. 10.

   Original Sentence, "As discussed below, while Stafford loans offer significant risk mitigation compared to PSLs, more than 40% of PSL borrowers do not exhaust their Stafford loan eligibility."

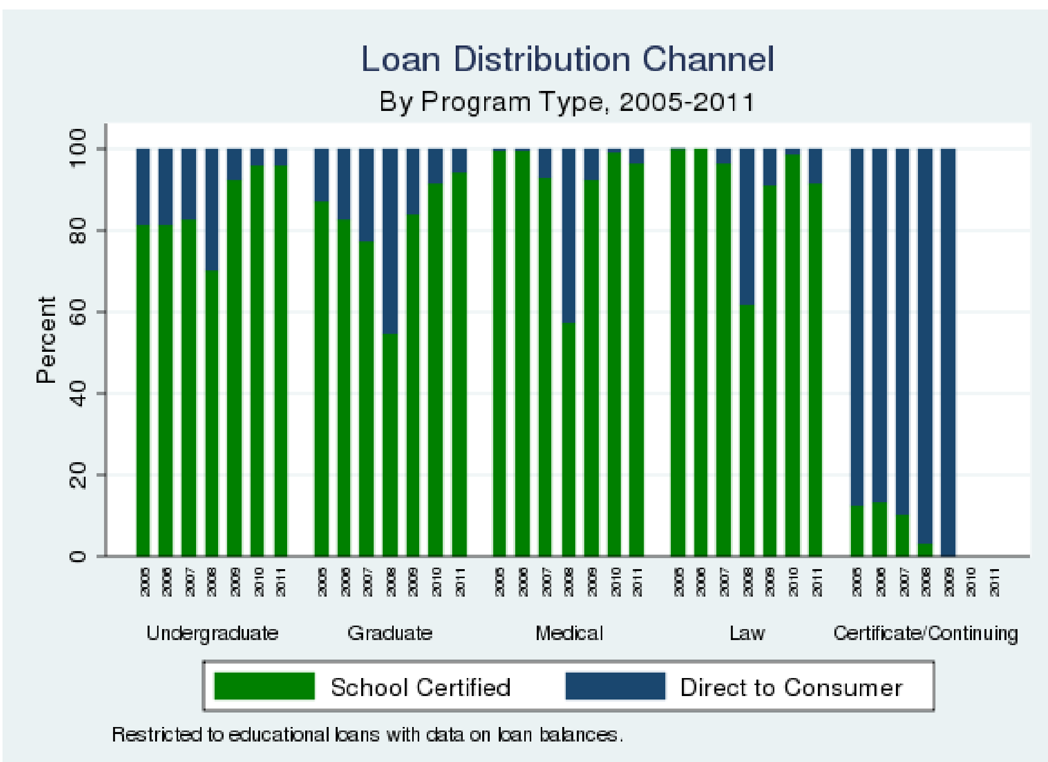
   Amended Sentence, "As discussed below, while Stafford loans offer significant risk mitigation compared to PSLs, more than 54% of PSL borrowers do not exhaust their Stafford loan eligibility, or do not even apply for federal aid."

3. Part One, p. 19.

Original Figure 6.



Amended Figure 6.



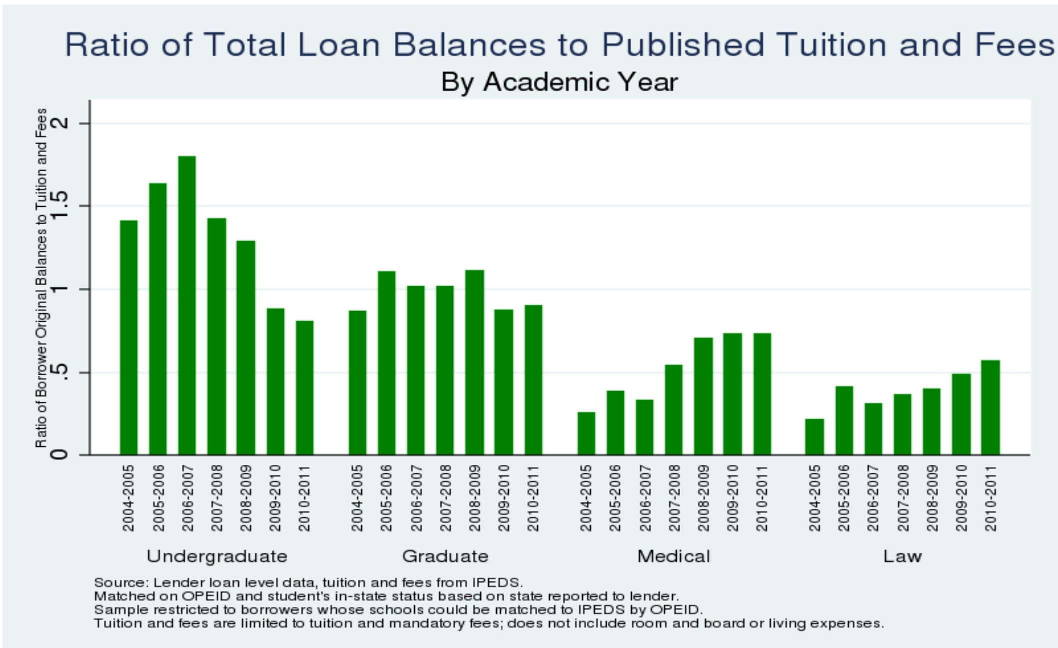
4. Part One, p. 19.

   <u>Original Sentence,</u> "By 2008, 27.8% of undergraduate loans were school certified, down from 60.0% in 2005."

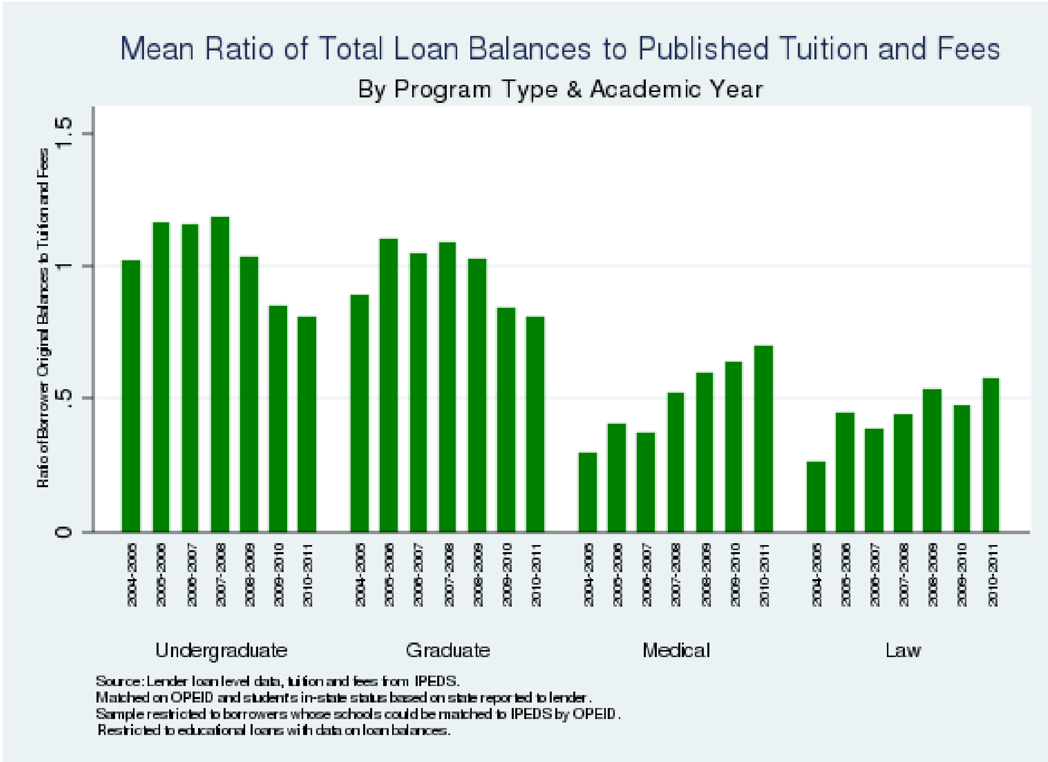
   Amended Sentence, "By 2008, 68% of undergraduate loans were school certified, down from 82% in 2005."

5. Part One, p. 20.

   <u>Original Figure 7</u>.

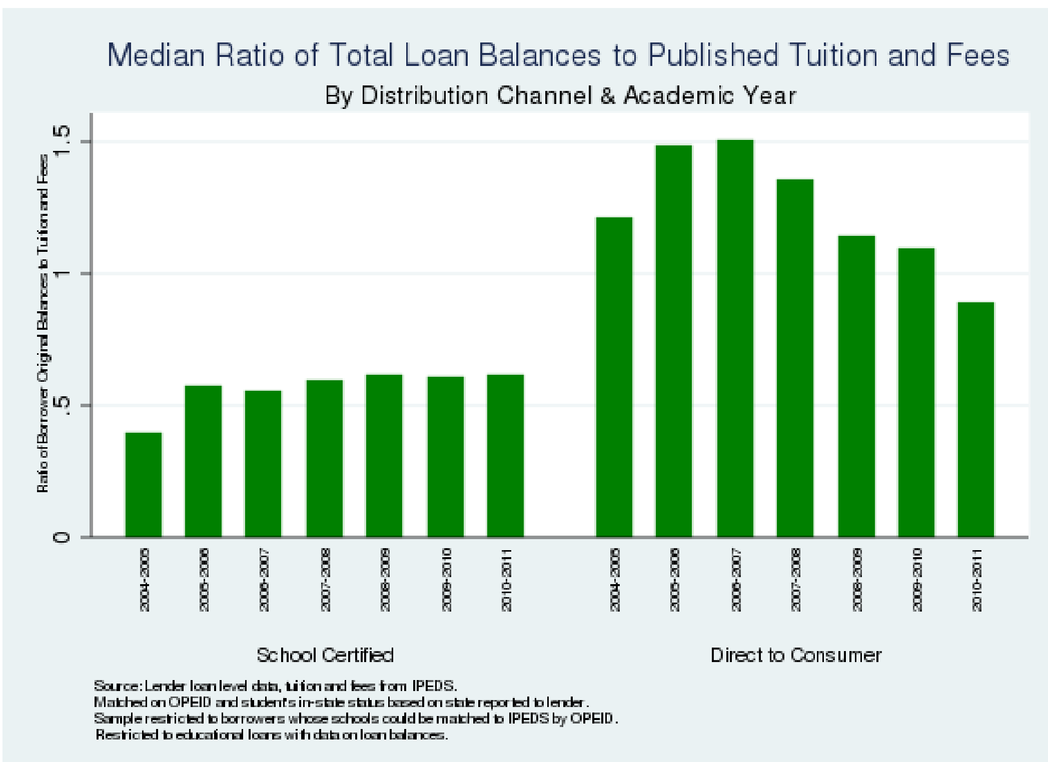


Amended Figure 7.



6. Part One, p. 21.

<u>New Figure 7A</u>.



7. Part One, p. 21.

   <u>Original Paragraph,</u> "As Figure 6 and Figure 7 show, undergraduate loan amounts and school certification of student need show a negative relationship. That is, loan amounts rose (as a percentage of tuition) as school certification decreased, and decreased when schools became involved again in later years, all in virtual lockstep. For medical and law students, where schools always remained involved, there was no comparable pattern. Changes in undergraduate loan amounts could reflect changes in other aid or changes in other family financing options, but the data does not support those hypotheses."

   Amended Paragraph "Figure 7A draws a comparison between school certified and DTC undergraduate lending by computing the median ratio of loan amount to tuition and fees by certification status for each year. The difference in the level of borrowing relative to tuition and fees is pronounced, although the difference decreased as lenders tightened underwriting standards during the sample period. Changes in undergraduate loan amounts could reflect changes in other aid or changes in other family financing options, but the data does not support those hypotheses."

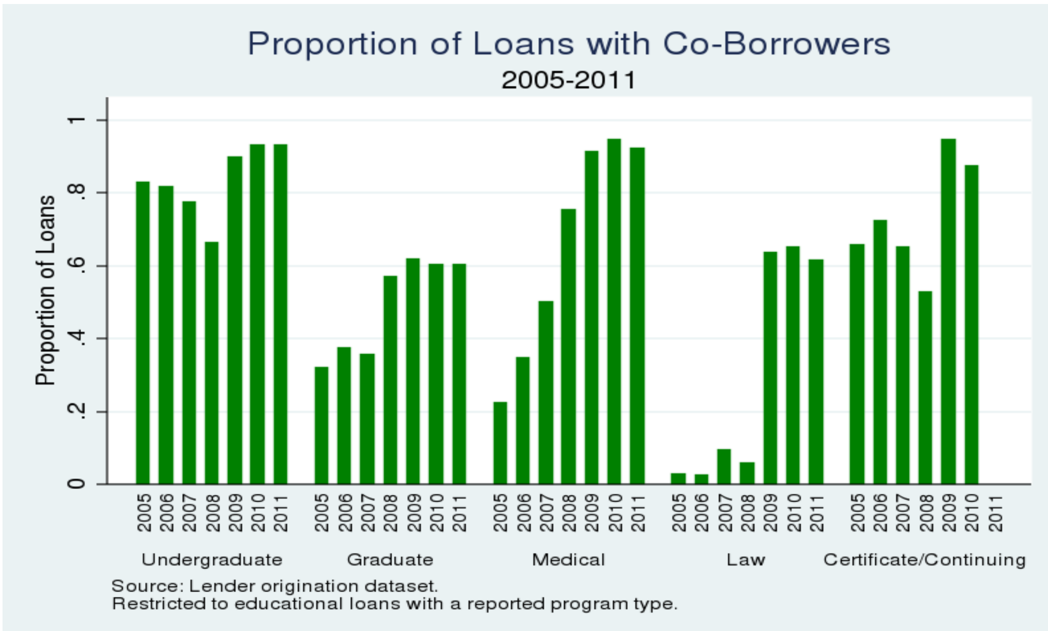
8. Part One, p. 22.

   <u>Original Paragraph,</u> "There is reason to infer that the spike in loan amounts was driven primarily by changes in the level of school monitoring of the loan process (due to a sidestepping of the financial aid office with the rise in DTC lending). In addition, the dramatic increase in individual annual loan amounts relative to tuition and fees reflects additive borrowing; students were borrowing more from Direct-to-Consumer lenders while maintaining other financial aid sources, that is, over-borrowing (borrowing more than the Expected Family Contribution) when schools were not providing controls on loan amounts. This comports with the fact that, absent school certification, lenders have no way of knowing what other debt aid the student has already incurred for the academic year. As school certification started to rebound in 2008, the proportion of total costs of education that students funded through PSLs fell precipitously."

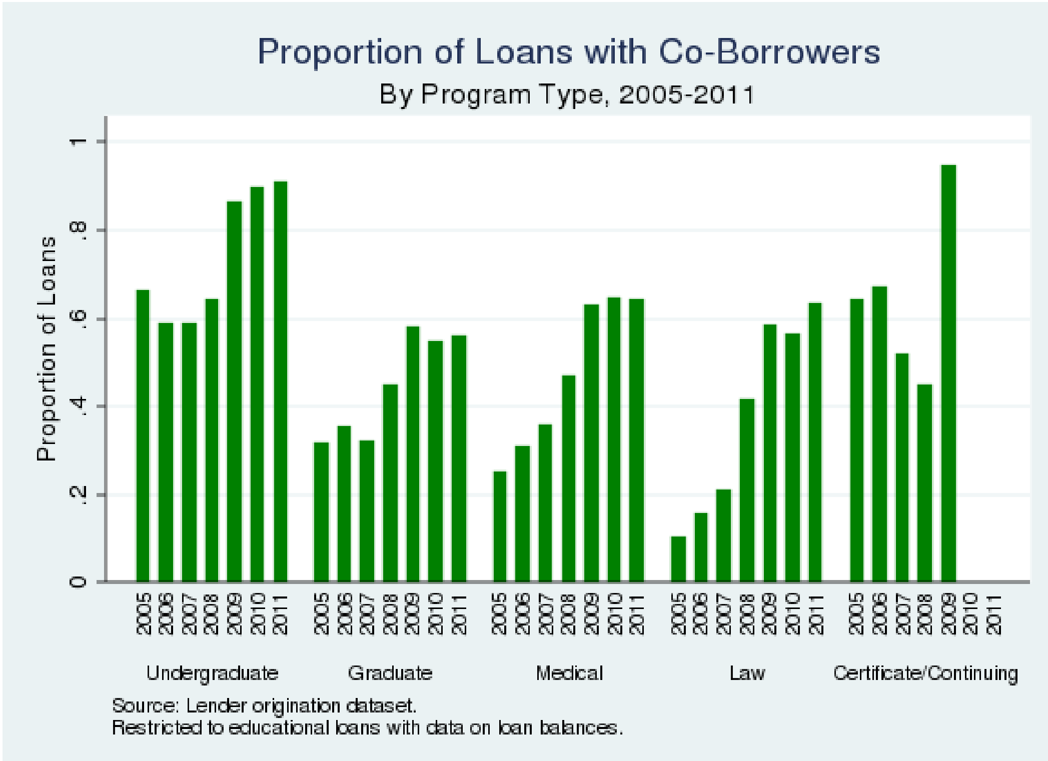
   Amended Paragraph "There is reason to infer that the increase in DTC loan amounts relative to tuition and fees reflects additive borrowing; students were borrowing more directly from lenders while maintaining other financial aid sources, that is, over-borrowing (borrowing more than the Expected Family Contribution). This comports with the fact that, absent school certification, lenders may not know what other debt aid the student has already incurred for the academic year. Notably, the difference in the level of borrowing between the school-certified and DTC channels narrows over the sample period, suggesting that as underwriting standards tightened the risk of over-borrowing was partially reduced."

9. Part One, p. 27.

   Original Figure 13.



Amended Figure 13.



10. Part Two, p. 38.

    Original Section, "63% had total monthly student loan payments (for both private and non-private loans) that were less than 5% of their monthly income and 80% have monthly student loan payments less than 10% of their income. 5% had monthly student loan payments of 25% or more of their monthly income."

    Amended Section, "63% had total monthly student loan payments (for both private and non-private loans) that were 5% or less of their monthly income and 80% have monthly student loan payments of 10% or less of their income. 5% had monthly student loan payments of more than 25% their monthly income."

11. Part Two, p. 41.

    Original Sentence, "There is no significant difference between the proportion of men and women who have only PSLs."

    Amended Sentence, "There is also no significant difference between the proportion of men and women who have only PSLs."

12. Part Two, p. 50.

    Original Sentence, "Many PSL borrowers who also have Stafford loans do not exhaust their loan limits: approximately 40% of PSL borrowers with Stafford loans do not borrow their individual Stafford loan maximum."

    Amended Sentence, "Many PSL borrowers do not exhaust their federal loan limits: approximately 54.5% of all PSL borrowers either do not borrow their individual Stafford loan maximum, or do not apply for federal aid at all."

13. Part Three, p. 69.

    Original Section, "Using the Sample Lender loan level data, the Agencies tested the level of over-borrowing (borrowing in excess of the EFC) by analyzing the changing relationship between PSL amounts and the tuition and fee component of the cost of the education for each individual borrower. Figure 7 demonstrates that the growth in the ratio of PSL loan amounts to tuition and fees is correlated with the securitization and lending boom (2005 – 2008). During that period other sources of financial aid for college were largely unchanged. Tuition and fees admittedly increased, but Figure 7 takes that increase into account, because the ratios are computed using actual tuition and fees for each year. The rapid growth in loan amounts as a multiple of core education costs suggests that a significant portion of the incremental borrowing relative to tuition and fees represents over-borrowing above and beyond financial need.

    As discussed in Part One, PSLs in the 2005-2008 period reflected increasing use of DTC lending, which circumvents controls on excessive loan amounts that can be provided by the school financial aid office. Figure 6 shows the growth of DTC lending and the reduction of school channel processing in the Sample Lender Data. During the period when DTC lending grew the most, PSL loan amounts reached 175% of tuition. Students borrowed materially more, relative to the core cost of school, without any reduction in other sources of aid. When lenders returned to school certification, PSL average sizes fell to 80% of tuition without any corresponding increase in the availability of federal loans for dependent undergraduates. Therefore, the Sample Lender data suggests that DTC lending is correlated with significant over-borrowing. Over-borrowing increases the likelihood of default, to the detriment of both borrower and lender. Lenders have learned this lesson, returning to certification of over 90% of undergraduate loans. But lenders' appetite for risk tends to ebb and flow – hence the concept of a credit *cycle* – and there is no assurance that, as memory of the financial crisis fades, lenders will stick to requiring certification. Public commenters from all constituencies, including lenders, suggested that school certification should be mandatory."

Amended Section "Using the Sample Lender loan level data, the Agencies tested the level of over-borrowing (borrowing in excess of the EFC) by analyzing the relationship between school certification status and PSL amounts as a percentage of the tuition and fee component of the cost of the education for each individual borrower. Tuition and fees admittedly increased during the sample period, but Figure 7 and Figure 7A take that increase into account, because the ratios are computed using actual tuition and fees for each year. Figure 7A illustrates the high levels of borrowing that are associated with DTC loans, as compared to school certified loans. During the period when DTC lending grew the most, DTC PSL loan amounts reached 151% of tuition. Notably, Figure 7A shows only the amount of private borrowing as a percentage of tuition and fees. It is likely that the median borrower took on federal student loans in addition to the PSL amounts that we analyzed. The high level of DTC loan amounts as a multiple of core education costs suggests that a significant portion of the incremental borrowing relative to tuition and fees represents over-borrowing above and beyond financial need.

Over-borrowing increases the likelihood of default, to the detriment of both borrower and lender. As of 2011, lenders appear to have at least temporarily learned this lesson, returning to certification of over 95% of undergraduate loans, and lending less than 90% of tuition and fees on the few loans that are not school certified. But lenders' appetite for risk tends to ebb and flow – hence the concept of a credit *cycle* – and there is no assurance that, as memory of the financial crisis fades, lenders will stick to requiring certification. Public commenters from all constituencies, including lenders, suggested that school certification should be mandatory."

14. Data Appendix I, p. 93.

    <u>Original Section,</u> "The relevant IPEDS was downloaded as custom datasets from the IPEDS Data Center (http://nces.ed.gov/ipeds/datacenter/) between March 14, 2012 and April 10, 2012 for academic years 2004 through 2011 (the 2011 data was early release data at the time it was downloaded). While OPEID is a variable in IPEDS, it is not reported by all institutions in all years."

    Amended Section, "The relevant IPEDS was downloaded as custom datasets from the IPEDS Data Center (http://nces.ed.gov/ipeds/datacenter/) between March 14, 2012 and April 10, 2012 for academic years 2004 through 2011 (the 2011 data was early release data at the time it was downloaded). These IPEDS datasets contain all Title IV participating institutions, plus non-Title IV institutions that voluntarily submit data to IPEDS. While OPEID is a variable in IPEDS, it is not available for all institutions in all years.”

15. Data Appendix I, p.94.

    Original Phrase, “For each school, tuition and fee variables were created for in-state and out-of-state students for each type of program by summing tuition and fees for each type of program”

    Amended Phrase, “For each school, tuition and fee variables were created for in-state and out-of-state students for each type of program by combining the average tuition and average fees for each type of program”

16. Data Appendix I, p.94.

    Original Sentence, “For the 53,717 school-year pairs in the IPEDS sample, this crosswalk updated OPEID in 24,415 (45.5%) of the records.”

    Amended Sentence, “For the 53,717 school-year pairs in the IPEDS sample, this crosswalk updated a missing OPEID in 24,415 (45.5%) of the records.”

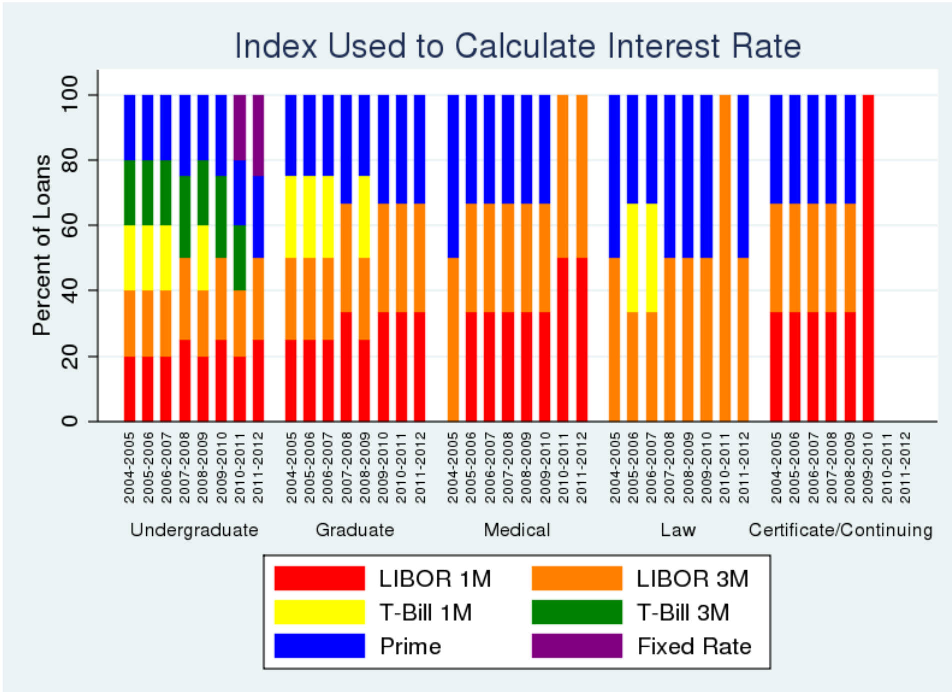
17. Data Appendix I, p.95.

    Original Paragraph, “In the loan level data, program type was imputed for records with missing values where the borrower reported attending the same educational institution in the record that immediately chronologically precedes the record with the missing value by attributing the next earliest non-missing response of program type for that borrower-lender pair at that institution. As a result of this procedure, program type was imputed in 40,539 records.”

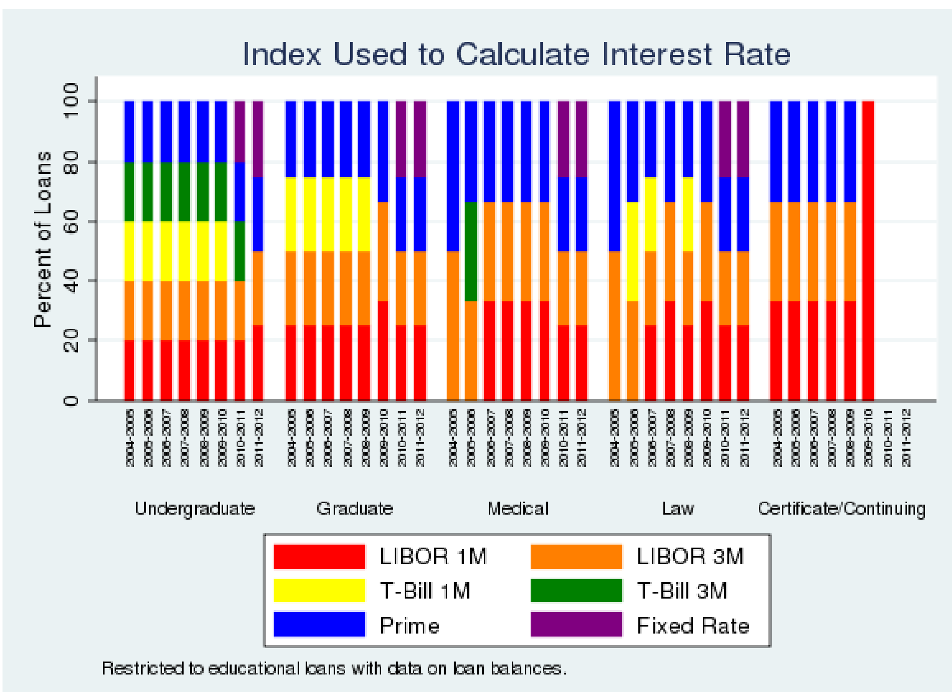
    Amended Paragraph, “In the loan level data, program type was determined using the “Year in School” variable to distinguish between Undergraduates and Graduates, and the “Course” variable to split Graduates into Graduates, Medical, and Law. Program type was categorized as Certificate/Continuing where “Year in School” and “Course” produced a “Not Applicable,” “No Data,” or “Other” program type and the “Program Type” variable was “Certificate/Continuing.” This left 516,197 observations as “Not Applicable,” “Other,” or “No Data.””

18. Data Appendix II, p. 96.

<u>Original Appendix Figure 1</u>

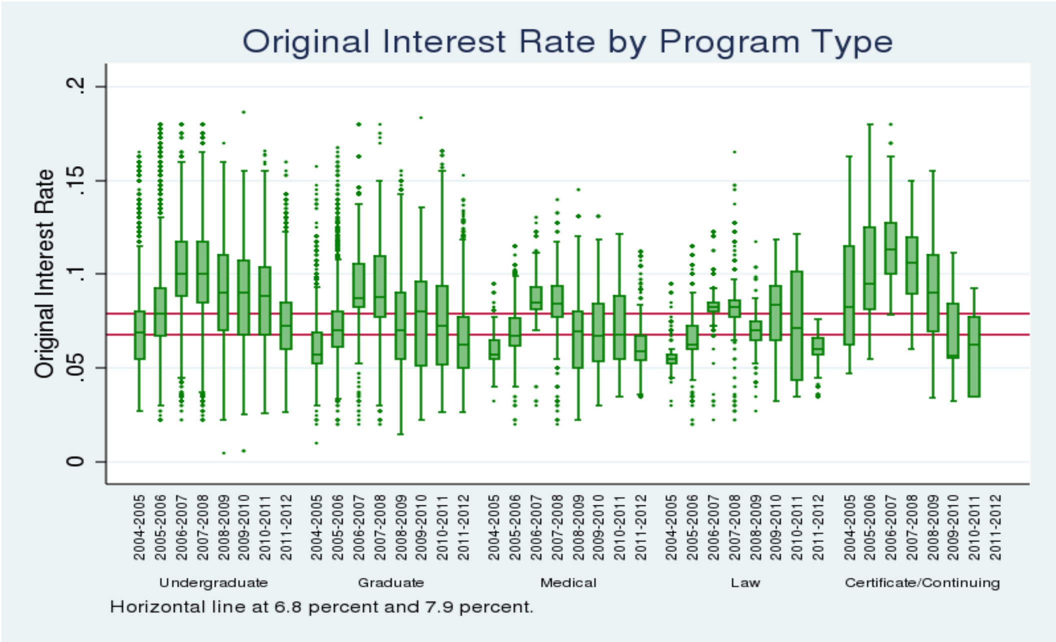


Amended Appendix Figure 1

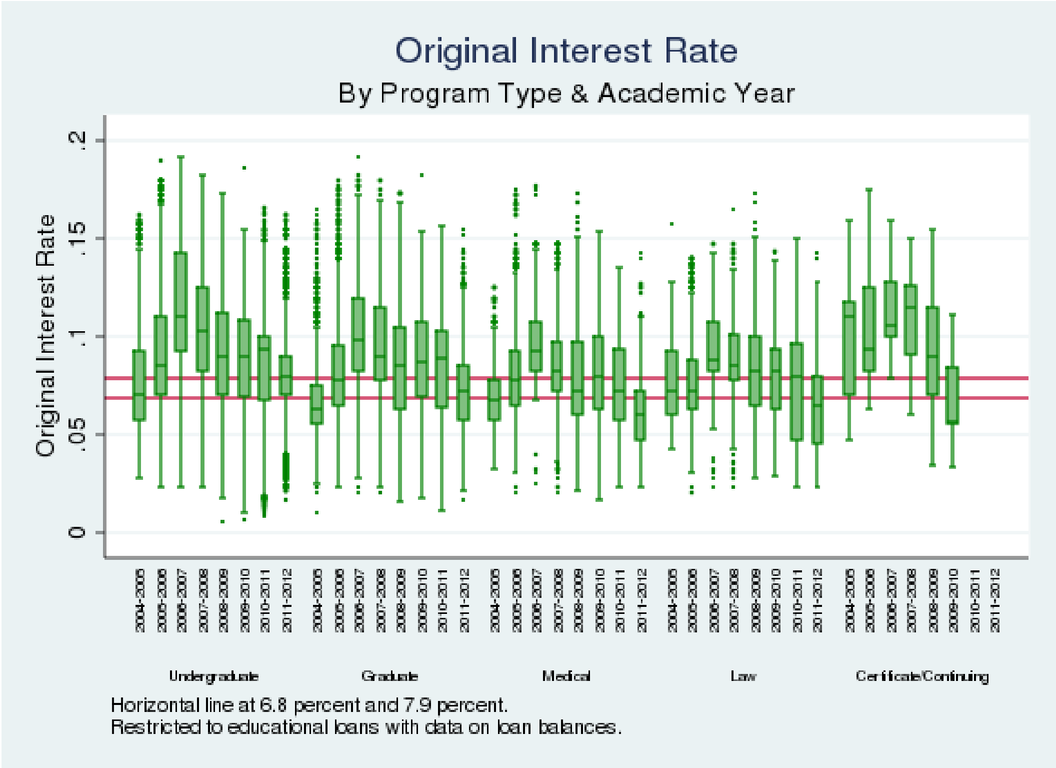


19. Data Appendix II, p. 97.

<u>Original Appendix Figure 2.</u>

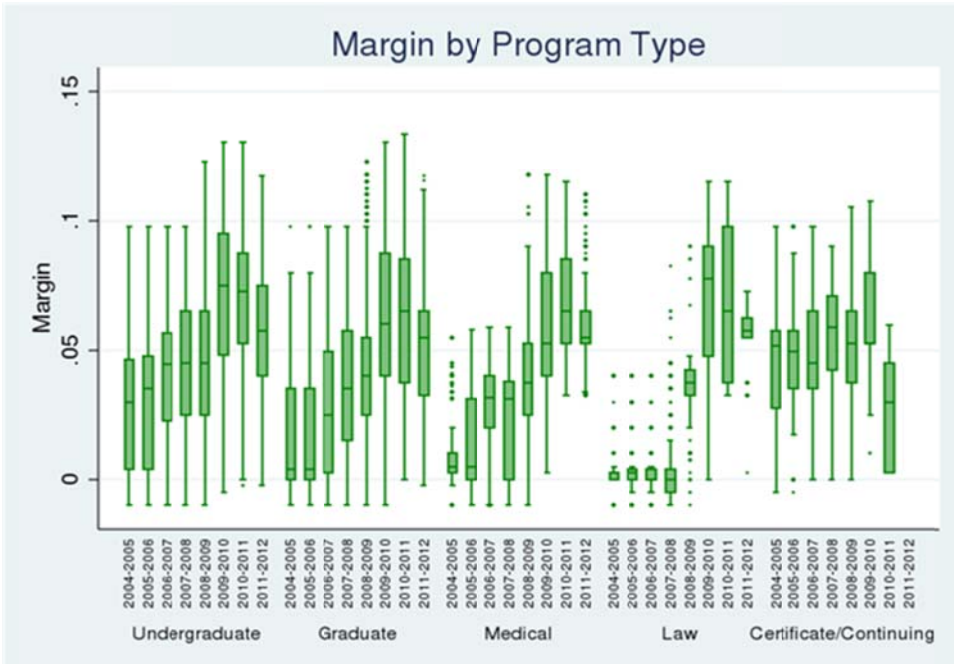


Amended Appendix Figure 2.

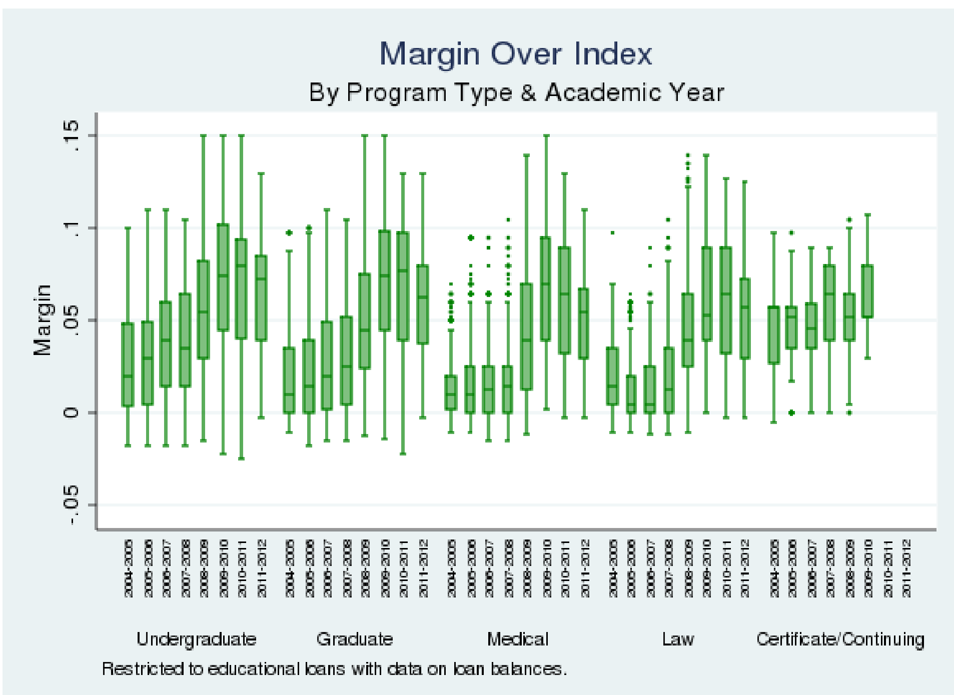


20. Data Appendix II, p. 98.

<u>Original Appendix Figure 3.</u>

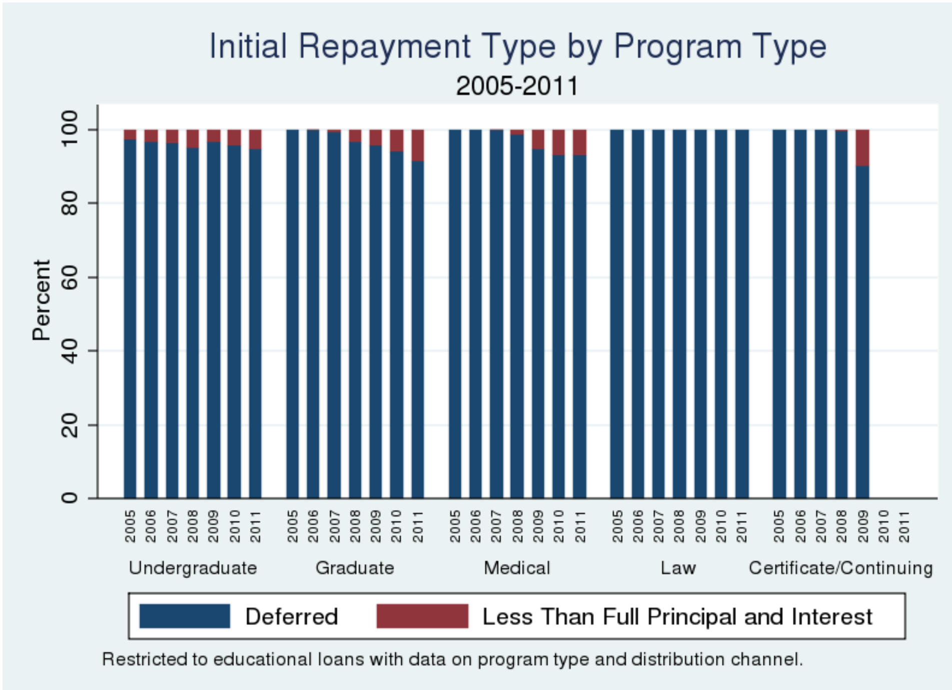


Amended Appendix Figure 3.

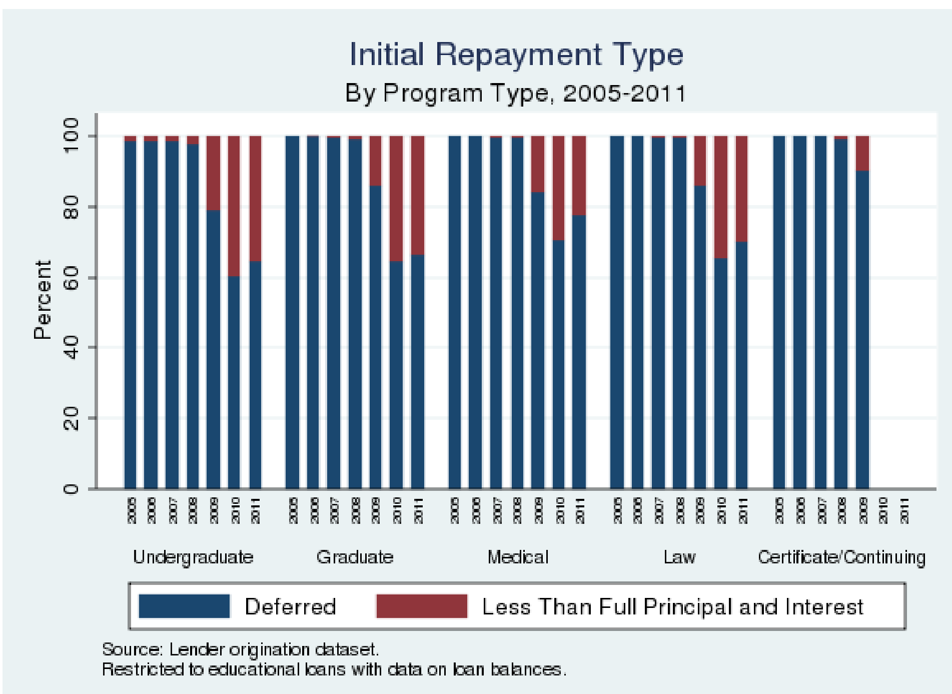


21. Data Appendix II, p. 100.

<u>Original Appendix Figure 5.</u>



Amended Appendix Figure 5.



22. References and Notes, p. 115.

Original Note 44, “Throughout the sample period, all loans for medical and legal programs were school certified. The proportion of undergraduate educational loans that were school certified increased from 27.8% in 2008 to 80.1% in 2009. Similarly, the proportion of graduate loans that were school certified increased from 26.3% in 2008 to 92.9% in 2009.”

Amended Note 44, “The proportion of undergraduate educational loans that were school certified increased from 68% in 2008 to 92% in 2009. The proportion of graduate loans that were school certified increased from 52% in 2008 to 84% in 2009. The proportion of medical school loans that were school certified increased from 57% in 2008 to 92% in 2009. The proportion of law school loans that were school certified increased from 61% in 2008 to 91% in 2009.”

23. References and Notes, p. 116.

Original Note 45, “Please note that total cost of attendance includes tuition and fees, room and board, books, and transportation and therefore exceeds the cost of tuition and fees alone. Additionally, considering that our Sample Lender data shows a 40% share of DTC in 2005, it is probable that the trend toward DTC, non-school certified, PSL lending was already well underway by the time our sample period started. Also note that because borrowers cannot be linked across lenders in the loan-level data these values represent within-lender loan amounts relative to tuition and fees and do not account for amounts individuals borrowed in an academic year across multiple lenders. Therefore, the amounts used in the computations may actually understate the ratio of loan amounts to costs.”

Amended Note 45, “Please note that total cost of attendance includes tuition and fees, room and board, books, and transportation and therefore exceeds the cost of tuition and fees alone. Because the loan level data does not specify whether a student lives on campus, off campus, or with family, total cost of attendance cannot be determined for individual students. When the ratios are calculated as if all students lived on campus and room and board costs are added to tuition and fees the ratios are smaller, by necessity, but the overall pattern over time and across channels is similar to that presented in Figure 7A. Also note that because borrowers cannot be linked across lenders in the loan-level data, these values represent within-lender loan amounts relative to tuition and fees and do not account for amounts individuals borrowed in an academic year across multiple lenders. Therefore, the amounts used in the computations may actually understate the ratio of loan amounts to tuition and fees.”

24. References and Notes, p. 116.

Original Note 46, "Graduate students not at professional schools experienced a change in school certification level similar to undergraduates, but graduate students did not show a similar pattern of change in ratio of loan amounts to tuition and fees. The differences may be attributable to materially higher limits on graduate Stafford loans and, later in the period, Grad PLUS loans. Please see table at Note 14." Note 46 was deleted as the associated text was removed and the note is no longer relevant.

25. References and Notes, p. 118.

Original Note 52, "The mix of payment options used by borrowers has also shifted. In 2005, most loans were fully deferred, like federal Stafford loans. After the crisis, Sample Lenders reported incenting borrowers through pricing and underwriting to make some payments during school, either accrued interest or a nominal payment of as little as $25. Although throughout the sample period the majority of educational loans are fully deferred, Appendix Figure 5 shows that the share of loans that require some payments during school increases over the sample period: for undergraduate loans in 2005, 2.6% of loans require partial principal and interest payments during enrollment. By 2011, this proportion had doubled to 5.2%. Also, while partial repayment did not exist for graduate and professional school in 2005, partial repayment loans are observed starting in 2006 for graduate loans, 2007 for medical loans, 2008 for certificate/continuing education loans (In contrast to other graduate and professional schools, partial repayments are not observed for law school loans)."

Amended Note 52, "The mix of payment options used by borrowers has also shifted. In 2005, most loans were fully deferred, like federal Stafford loans. After the crisis, Sample Lenders reported incenting borrowers through pricing and underwriting to make some payments during school, either payment of accrued interest or a nominal payment of as little as $25. Although throughout the sample period the majority of educational loans were fully deferred, Appendix Figure 5 shows that the share of loans that required some payments during school increased over the sample period: for undergraduate loans in 2005, 1% of loans required partial principal and interest payments during enrollment. By 2011, this proportion had increased to 35%. Also, while partial repayment was not observed for graduate and professional school in 2005, partial repayment loans are observed starting in 2007 for graduate, law, and medical loans and in 2008 for certificate/continuing education loans."

26. References and Notes, p. 124.

<u>Original Note 123</u>, "Obtained by dividing the percentage of PSL borrowers who obtained a Stafford loan and received less than the maximum amount (31.4%) by the total percentage of PSL borrowers who received Stafford loans (the 31.4% of PSL borrowers that did not exhaust their Stafford loan limits and the 45.5% of PSL borrowers who exhausted their PSL)."

Amended Note 123, "Obtained by summing the percentage of PSL borrowers who obtained a Stafford loan and received less than the maximum amount (31.4%) with the percentage who applied for but did not receive a Stafford loan (10.9%) with the percentage who did not apply for a Stafford (12.2%)."

Log of Corrections of Typographical Errors:

1. Part One, Fig 10 and 11, sources corrected.
2. Part Two, p. 37, infographic corrected, to 14% from 9%. Also 96% and 97% were incorrectly transposed and are now corrected.
3. Part Two, source to Tables 15, 16, 17, 18, 19 corrected.
4. Part Two, notes to Table 13 corrected.
5. Part Three, p. 76, corrected "consider" to "considered"
6. Part Three, p.76, removed "are" from "submissions are based"
7. Part Three, p. 76, added "a" to "in considerable increase"
8. Part Three, p. 76, added "to" to "five years capture"
9. Part Four, p. 80, corrected "set" to "sets"
10. Part Four, notes to Table 21, 22 corrected.