briefing paper

Subpriming Indiana Students:
Why We Need a Strong Consumer Financial Protection Agency

Introduction: Student Borrowing in Indiana

Now more than ever, Indiana's future depends on the educational and economic success of its young people. Yet with tuition skyrocketing and entry-level jobs flat-lining, students in the state are borrowing more and more against their futures to pay for school. A startling 62 percent of Indiana graduates last year had student debt, averaging $23,264 per indebted student.[1] While most of that debt is in safe, lower-interest federal loans, a significant amount is in private loans that can carry interest rates of over 18 percent.[2] In fact, last year Indiana students graduated with an average of $3,556 in non-federal loans.[3] That's like putting the entire cost of tuition and books for a semester at Indiana University on a high-interest credit card that students can't pay off for years.[4] And like credit cards, private loans carry costly penalties and fees and are marketed heavily to students regardless of need, resulting in unnecessary and damaging levels of expensive debt. Unfortunately, unlike with credit cards, there has been no "Credit Card Holder's Bill of Rights" for student loans to reign in the worst abuses in the private loan market. This absence of basic consumer protections is why Indiana students need a new consumer watchdog.

The Consumer Financial Protection Agency

Americans overwhelmingly support[5] enacting a strong Consumer Federal Protection Agency (CFPA) that can, like the FDA does for drugs and the Consumer Product Safety Commission does for toys and electronics, keep us safe from toxic financial products. A consumer agency would help curb the lending industry excesses responsible for the dramatic rise in high-interest debt and ultimately, for the financial meltdown and bailouts last fall. It would close the gap that currently leaves private lenders free to make abusive loans to students without supervision or limits. If Congress enacts a strong Consumer Financial Protection Agency, Indiana's students stand to benefit from more disclosure and fairer pricing.

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The For-Profit School Loophole

However, a loophole in the House CFPA bill could allow certain colleges—those that are run solely to make a profit—to make private loans to students without abiding by the CFPA's consumer protections.[6] This exemption would leave the more than 33,000 Indiana students who attend for-profit schools[7] vulnerable to abusive loans. For-profit students are already burdened with the highest average debt loads in the nation, at $32,650 nationwide, versus $22,380 for private non-profits and just $17,700 for public colleges.[8] And they are most likely to have dangerous—and unnecessary—private student loans.[9] But due to intense lobbying, Congress is poised to create a permanent loophole allowing for-profit colleges to operate under a different set of rules than the rest of our nation's colleges.

Why For-Profit Schools Should Not be Exempt

In Indiana and across the country, for-profit schools aggressively market to vulnerable students: the unemployed or underemployed who are seeking better job opportunities. They advertise on billboards, daytime commercials and bus stops, often offering training in a vocational field such as hair and beauty, auto repair or medical assistance. And while some for-profit schools serve a genuine need in the community and treat their students well, as a sector, for-profit schools have been plagued with well-document abuses: from poor instruction and low graduation rates to false advertising, high-pressure sales tactics and convictions for loan fraud.[10] Even the best of these schools have a profit motive (unlike the majority of colleges, which are non-profit private, parochial and public schools), meriting some supervision to ensure that the loans they make to their students are fair.

Unfortunately, traditional market forces are not sufficient to guarantee the safety of these loans. They are profitable to schools even if students eventually default because of the loan's high cost or because the school fails to prepare them for the high-paying job that was advertised. In one example, for-profit chain Corinthian Colleges has reported to investors that it will issue $130 million in loans this year even though it expects an astonishing *56 to 58 percent of the borrowers to default*. Defaulting on an expensive student loan—which is not dischargeable upon disability, bankruptcy or even death[11]—can spell financial ruin for an already strapped job-seeker. But for the schools, making direct "easy credit" loans is still profitable because the loans increase enrollment, unlocking millions in federal grant and loan dollars and buoying their stock price.[12]

Typical Abuses in the Private Loan Market, and the For-Profit School Connection

Aggressive marketing has resulted in America's students taking out $120 billion in private loans over the past decade[13], but there is still no consumer watchdog to make sure they are treated fairly. There are virtually no rules protecting borrowers in the private loan market. Just about any company or school can offer a high-cost loan and market it to students as a "student loan," at any terms it finds profitable. Typical private loan abuses include:

- **Unnecessary Loans**. Any student with access to the full information should only buy a more expensive private loan after reaching the maximum federal loan amount first. However, full information is increasingly the exception, and not the rule. Last year, almost 2 out of every 3 private loan borrowers did not reach the Stafford limit before taking out a costlier private loan; 26 percent took out no Stafford loans at all. As with other high-cost financial products, from subprime mortgages to payday loans, racial disparities suggest predatory targeting: African Americans are disproportionately likely to use private loans.[14]

- **Outrageous Rates.** Unlike federal loans, most private loans have no upper limit on their interest rates. As a result, private student lenders charge annual percentage rates (APR) as high as 18 percent—nearly three times the average federal loan APR and twice as high as the federal cap on student loans.[15]

- **Rate Floors, Not Ceilings.** During the recession, the federal government has lowered interest rates to make money cheaper for lenders—but the savings have not flowed through to millions of private loan borrowers. That's because instead of ceilings, many private loans have rate "floors" guaranteeing that the borrower's interest rate stays high. The resulting spread that lenders are pocketing is as high as 12.5 percent.[16]

- **High Fees.** There are no legal limits on the fees private lenders can charge students. Eighty-five percent of lenders charge origination fees just to make the loan, averaging 4.5 percent of the loan

amount—but with some as high as 9.9 percent.[17] For a $5,000 private loan, that's a $495 fee added to the principal before the student even enters the classroom.

- **In-School Interest**. With federally-subsidized loans, the government pays the interest while the student is in school and not making payments. Private lenders start running the clock from the moment of origination. The difference is significant: an Indiana University freshman who takes out a private loan for $1,500 at the start of the year will owe $2,945 on that loan alone the day she graduates. Taking out the same private loan for each year of study will leave her with a bill upon graduation of $9,223—for just $6,000 in loans.[18]
- **Aggressive Marketing at For-Profit Schools.** While only 9 percent of undergraduates attend for-profit schools, these students make up 27 percent of private loan borrowers.[19] As aggressive marketing has driven record growth in private loans, the biggest rise has been among for-profit schools. *Nearly half* of all for-profit school students had private loans last year, up from just 12 percent four years earlier.[20]

Conclusion

It should be our shared responsibility to help Indiana youth build a strong foundation for our future. If we let profit-seeking companies target our students with "easy credit" that they'll be struggling to pay off for years, our economy will suffer in the long-run. A Consumer Financial Protection Agency—with no loopholes for private loans or for-profit schools—will help us guarantee all Indiana students an affordable education.

Endnotes

1. The Institute for College Access & Success, College InSight (beta), at http://www.college-insight.org.
2. National Consumer Law Center, "Paying the Price: The High Cost of Private Student Loans and the Dangers for Student Borrowers," March 2008.
3. The Institute for College Access & Success, College InSight (beta), at http://www.college-insight.org. This figure includes students who graduated with no debt; of only indebted students, the estimate would be higher.
4. One half of in-state tuition at Indiana University-South Bend is $2,881; one-half of the estimated cost for books and supplies is $558 for the 2008-2009 school year. National Center for Education Statistics, 2009.
5. Benenson Strategy Group, Americans and Financial Reform Poll Memo, Oct. 14, 2009, available at http://www.seiu.org/mediakit/pdfs_1/FinancialReformPollMemo.pdf.
6. "Coalition Letter on School Loan Exemption in H.R. 3126, Consumer Financial Protection Agency," Oct. 8, 2009, available at http://projectonstudentdebt.org/files/pub/LtrtoFrank_CFPA_pls_10-08-09.pdf.
7. The Institute for College Access & Success, College InSight (beta), at http://www.college-insight.org.
8. College Board, "Trends in Student Aid 2009," at http://www.trends-collegeboard.com/student_aid/4_1_loans_f.html?expandable=0.
9. The Project on Student Debt, "Private Loans: Facts and Trends," August 2009.
10. Stephen Burd, "The Subprime Student Loan Racket," *Washington Monthly*, Sept. 11, 2009, available at http://www.washingtonmonthly.com/features/2009/0911.burd.html.
11. Lauren Asher, President, the Institute for College Access & Success, Testimony before the House Committee on the Judiciary Subcommittee on Commercial and Administrative Law Oversight Hearing: "An Undue Hardship? Discharging Educational Debt in Bankruptcy", Sept. 23, 2009, available at http://projectonstudentdebt.org/files/pub/Asher_testimony_90923.pdf
12. Consumer Coalition Letter, "Re: School Loan Exemption in H.R. 3126 Consumer Financial Protection Agency," Oct. 8, 2009, available at: http://projectonstudentdebt.org/files/pub/LtrtoFrank_CFPA_pls_10-08-09.pdf.
13. College Board, "Trends in Student Aid 2009," at http://www.trends-collegeboard.com/student_aid/4_1_loans.html?expandable=0.
14. The percentage of African American college students who took out private loans quadrupled between 2003-04 and 2007-08, from 4 percent to 17 percent. The Project on Student Debt, "Private Loans: Facts and Trends," August 2009.
15. National Consumer Law Center, 2008. The average Federal Stafford Loan is 6.8 percent, according to the U.S. Department of Education http://www.ed.gov/programs/ffel/index.html.
16. Student Loan Analytics, Nov. 3, 2009, at http://studentlendinganalytics.com/ratings.html.
17. National Consumer Law Center, 2008.
18. Calculations based on 18 percent interest, 46, 34, 22, and 10 months capitalization.
19. The Project on Student Debt, "Private Loans: Facts and Trends," August 2009.
20. The Project on Student Debt, "Private Loans: Facts and Trends," August 2009.