U.S. Senate
Committee on Health, Education, Labor & Pensions

Field Hearing
"Fulfilling the Promise of an Affordable College Education"
The Ohio State University - Columbus, Ohio
April 21, 2008

Testimony of Donald J. Kohne, Managing Director
Student Lending Works
West Chester, Ohio

Good Morning, Mr. Chairman: I am Donald Kohne, Managing Director of Student Lending Works based in West Chester, Ohio. We are the State of Ohio's designated nonprofit student loan lender. Our public purpose mission is to help Ohioans access and afford a higher education. We serve as an eligible lender of federal student loans under the Federal Family Education Loan Program (FFELP). By utilizing our partnership with the State, our non-profit status, and our access to tax-exempt funds, we offer the lowest-cost loans of any lender in Ohio. We are a subsidiary of KnowledgeWorks Foundation, Ohio's leading philanthropic education foundation, which has invested more than $100 million directly into transforming Ohio's education system. We were very pleased last summer to welcome Mr. William Jawando, your education aide, to our offices and trust he can attest to the much needed service we are providing Ohio's students and families.

I have been in the nonprofit student loan industry for more than 20 years and, quite frankly, have never seen so many challenges facing the FFELP program at one time. This program serves almost 80% of the students and parents who need to take out a federal student loan for the

purpose of investing in a college education. Together with guarantee agencies and the US Department of Education, this program is operated by private-sector lenders, many of whom are nonprofit agencies like us who are focused on promoting college access and affordability in their particular states.

The Crisis

The primary challenge facing Student Lending Works and many other FFELP lenders concerns our ability to secure the financing necessary to make student loans in the upcoming academic year. The sub-prime mortgage crisis is causing collateral damage and significantly impacting those securities backed by federally guaranteed student loans. Student loan securities have historically been viewed by investors as assets of the highest credit quality because the loans supporting the securities are 97% guaranteed by the federal government and have low default rates. Now, student loan securities are suffering much the same fate as other classes of asset backed securities of much lower credit quality. As a result of the sub-prime crisis, the market for student loan-backed securities has virtually shut down. In the first quarter of 2008, no financings for new student loans were completed. A lack of financing at this level hasn't occurred in 40 years and will force many families to forgo school or tap into their home equity or retirement plans to pay for college.

I have seen a few financial crises in my career, such as the interest rate spikes of the early 1980s, the S&L crisis, and the collapse of the junk bond market. But, this is the first time the student loan program and higher education have been so directly impacted. The current state of the

student loan capital market presents a crisis on a large scale for students and their families – a point made quite clearly by witnesses at a Senate Banking Committee hearing last week.

There are some who claim that no crisis exists. Let me be very clear. This crisis does exist! Its effects will be felt very soon on college campuses throughout the nation, as we are already seeing lenders exit the market and/or suspend their programs without warning. Action must be taken before it's too late.

The main consequence of this crisis is that many students will not have enough funding to pay for school this Autumn. As a result, colleges will see a drop in attendance, especially among those students from lower and middle income households, many of whom are dependent on student loans to cover the cost of attendance. And we all know that taking a leave from college drastically increases a student's likelihood of not completing their degree.

Consider this scenario…John Smith, a second-year college student who worked hard his freshman year to establish a good grade point average, has received his financial aid letter and is told he has a shortfall of $11,000 between the aid he is receiving and the cost of attending his college for the next school year. He had planned to make up the difference through Stafford and PLUS loans. But, the lender he used last year is no longer offering loans. He is now forced to find a new lender who has funds available. At this point, John and his parents may find that there are no lenders available to them because most lenders with available funding have already gone through their processes and have disbursed their available funds.

The alternative is that John Smith and many other students may turn to private loans to fund their educations. The problem is that the capital markets for these loans are in far worse shape than the market for federal loans. Many lenders are also leaving the private loan market. For those remaining in the market, many parents and students will be unable to qualify for their private loans, as many lenders are requiring higher credit scores than last year due to the current credit crunch. What makes this situation worse is that many students and their families depend on the *combination* of federal student loans and private loans to fund their college educations.

As for other sources of funding, for those borrowers who qualify for Pell Grants, the recent Pell funding increases are unfortunately not nearly enough to allow them to attend school this Autumn without any borrowing. There simply will not be enough other grant and scholarship funding available to help students cover the shortfall that will arise from an inability to access student loans. The problem will be especially acute on private school campuses where the tuition is typically much greater than available grant support.

The long-term consequences of these funding shortfalls will impact state unemployment, hinder the cause of Ohio higher education, and damage for years to come the vision of the State to develop a highly-skilled workforce. Those most impacted will be at-risk and first generation college students.

Options Under Consideration

So, what is the solution? All of the ideas you are currently reviewing have some merit. As is so often the case, this crisis will be solved through the application of multiple solutions. Key to any

solution is the understanding that we must focus on the FFELP program because it is the existing channel – and unlike other options, does not need to be created from scratch or doubled or tripled in size. FFELP is the single largest source of financial aid for students attending college. So, making FFELP work is the most critical component of an effective solution. We need to examine most closely proposals that will immediately make the financial markets operational again for the purpose of funding new student loans this Autumn.

Both Chairman Kennedy in the Senate and Chairman Miller in the House have proposed bills that would expand the Federal Direct Loan Program, clarify the authority of the Secretary of the U.S. Department of Education concerning the Lender of Last Resort program, and authorize the Secretary of Education to purchase student loans from lenders - a process being referred to as the Secondary Market of Last Resort. The House last week passed the Miller bill.

As for the Federal Direct Loan Program, it is not realistic to think that this program can be expanded to the degree needed to meet the funding shortfall facing FFELP or to meet the service needs of students and institutions.

The Lender of Last Resort Program is a provision of the Higher Education Act that has previously existed only on paper. The program is untested and would be difficult to plan, develop and make operational in time to make a significant dent in the shortfall of student loan funding needs for the coming academic year.

The Secondary Market of Last Resort Program, as described in S. 2815, calls for the Secretary to purchase student loans from lenders. Based on the current language of S. 2815, the program would end up being effective only as a mechanism for lenders to sell off their portfolios and exit student loan lending. We do not believe this is the intent of the bill. Lenders remaining in the program would be expected to sell higher yielding loans originated prior to October 1, 2007 (the date of enactment for the College Cost Reduction Act), and in turn use such monies to originate post-October 1, 2007 loans which are lower yielding. We do not believe that lenders will act in this fashion. In addition, most student loans are housed in financing structures which require that when loans are sold, the proceeds from the sale are used to pay bondholders.

A Proposed Solution

There is, however, a proposal on the table that would provide an immediate solution to funding new student loans for the Autumn with little risk to and no financial outlay by the federal government. It is a proposal that has been incorporated to some extent into H.R. 5715 passed last week in the House.

If lenders were permitted to enter into "Standby Loan Purchase Agreements" with the federal government, whereby lenders would have the right and option to sell to the federal government a specific amount of loans at specific times, the lenders could go to the short-term money markets, as distinguished from the long-term securitization markets, and raise the funds necessary to meet the student loan needs for the upcoming academic year.

What is attractive about this proposal is that it is difficult to conceive of a set of circumstances in which the option to sell to the Department would actually be exercised, and lenders would end up actually selling loans to the Department. But the mere existence of this backstop will put a floor on the value of the loans and give confidence to investors to again purchase student loan securities. And the benefit for the federal government is that it can charge a reasonable fee to the lenders in return for providing this backstop.

The "Standby Loan Purchase Agreement" concept is the only option proposed so far that has any serious chance of injecting enough new capital into the student loan system to ensure that all Ohio parents and students will be able to pay their college bills come July through October.

We are pleased that the concept was added to H.R. 5715 and would encourage the Senate to add this provision to S. 2815.

As the State of Ohio's nonprofit student loan lender, our primary purpose is to ensure that Ohioans can pay for college. We are confident that the "Standby Loan Purchase Agreement" concept will permit us to fulfill this purpose in the upcoming academic year. Without it, this purpose will be severely compromised – and it is Ohio students, parents, and citizens who will pay the price.

Thank you! I am happy to answer any questions.