Testimony of Chuck Sanders
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The House Committee on Education and Labor

Ensuring the Availability of Federal Student Loans
Friday, March, 14, 2008

Introduction: Mr. Chairman, Ranking Member McKeon, my name is Chuck Sanders and I am the President and CEO of the South Carolina Student Loan Corporation. Thank you for inviting me to come before you and for holding a hearing to discuss this very important issue -- ensuring the availability of Federal student loans for students and families both near and long term.

Prior to my role at South Carolina Student Loan, I was a municipal bond trader in the securities industry as well as Director of Investments and Debt Management for the South Carolina State Treasurer's Office. Thus, I have long term experience in both student loans and municipal financing. I would like to tell you a bit about our student loan program in South Carolina.

The South Carolina Student Loan Corporation was created by the South Carolina General Assembly in 1973 as a private, non-profit entity to administer the Federal Family Education Loan (FFEL) program in South Carolina. Since our inception, we have provided nearly $7 billion in higher education loans to over 423,000 families throughout the state of South Carolina. Our non-profit mission remains unchanged – to provide quality programs of financial assistance that enable eligible students and parents to pursue and achieve their educational goals. Without such financial assistance, families in South Carolina would not have been able to pursue their postsecondary education dreams. For the current academic year (2007-08), we have provided over $600 million in educational loans.

As a not for profit student loan provider and issuer of student loan bonds, I can tell you first hand the impact the current market situation has had on our ability, and that of our peers in other states, in securing the necessary financing to provide access to student loans. While the immediate issue is that of a skittish credit market and the need for liquidity and confidence to return to the market, the implications go beyond direct financings. It is important to note that the situation we find ourselves in is a collateral affect of a much broader credit market disturbance instigated by activities in the sub-prime mortgage market. It is not because student loans were poorly underwritten or

issued to ineligible or undeserving borrowers. Furthermore, the credit quality of this asset remains high. The problems in this market are not due to credit risk, but rather liquidity concerns. To repair the marketplace, then, it is necessary to inject liquidity and restore confidence. The Federal Government has the ability to help stabilize this irrational marketplace.

As you know, we provide a myriad of programs and services for students in a holistic approach to assisting students and families. Much of this is also at risk if the current market situation does not turn around. I will discuss that more directly later in my testimony.

Issues in the current market: In South Carolina, we have about $3 billion in outstanding student loan bonds and of that approximately 60% percent are in auction rate bonds, with the remainder in longer term variable rate securities. Currently, across the broader student loan market, industry reports indicate that of the roughly $350 billion in outstanding FFEL program loans, about $80 billion are financed via outstanding auction rate securities. Most of this auction rate debt was issued by non-profit lenders, because this mode of financing was our best option to keep borrowing costs low. It worked well for 15 years in providing us with a consistent and predictable source of low-cost capital.

Late last year, it became clear that the problems in the sub-prime mortgage market were having a negative ripple effect on the student loan capital markets. Initially, this meant a significant increase in financing costs, but the market remained intact. In the second week of February, however, the auction rate market collapsed when broker-dealers – who have their own balance sheet issues -- were no longer able to sustain the market by buying all the student loan securities that investors wanted to liquidate**.** Consequently, a raft of auction failures occurred, as sell orders vastly outpaced buy orders. This meant that some buyers had to hold the asset and were unable to sell for cash. This was a crushing blow, since the investor base for these securities existed because the asset has always been viewed as highly liquid. Once liquidity was no longer assured, many of these historic investors no longer saw a reason to be in the market. That investor base has

yet to be replaced, and may never be replaced. Thus, the student loan auction rate securities failure rate has in a relatively short time gone from zero percent to nearly 100 percent.

In South Carolina, we have had 28 failed auctions over the past several weeks and are now having to pay rates of more than 7 percent as compared to 3 to 4 percent just a short time ago. Some of my colleagues in this market are paying rates as high as 18 percent, at a time when the statutory yields we earn on FFEL program loans are roughly 4.5 to 5 percent. Several news reports have described how individual nonprofit lenders are losing millions of dollars on their loan portfolios each month. The point here is that many lenders are seeing a negative return on funds and they do not have other sources of capital to draw upon. This means that they can only continue under current market conditions for a circumscribed period of time. While this time period will vary for each lender, the basic dynamic is the same.

Because of this situation, we at South Carolina have been attempting to refinance our auction rate debt into another financing vehicle since October. We are experiencing difficulties in securing this financing, however, due to the apprehension of rating agencies, liquidity providers and investors.

In the meantime, the uncertainty concerning whether these refinancings can be accomplished – and at what price – creates a situation where my organization, and many of my peers, are unable to commit to funding the volume of loans we have in the past – or in some cases, any loans at all. Recently, of course, it was reported that the Pennsylvania Higher Education Assistance Agency and others have suspended new FFEL program loan originations, and I expect to see more such announcements in the coming months, unless the financing situation improves substantially.

Impact on Students and Families: Without some relief to this situation, I believe you will see additional loan providers reevaluating their participation in both the Federal and non-federal loan programs. This will undoubtedly create access issues for some in both the

FFEL program and non-federal lending. The South Carolina Student Loan Corporation provides both FFEL and non-federal loans. For many students, borrowing to finance their education is something they must do and we want to provide low cost loans to assist those students and families that need this assistance. We always encourage Federal and State grants and scholarships first. For some students, however, the non-federal loan is necessary to bridge the gap between federal loan limits and their cost of attendance. Both FFEL and non-federal loans are at risk due to this current market situation. While private lending has received some criticism, it often makes the difference between the dream and the reality of a higher education.

While disruption may not be widespread initially, the potential is there for many more students to soon be without their provider of choice. To this point, students and their families have benefited greatly from being able to shop around and find the best deal possible to them for financing their education. There are also genuine access concerns. Many students may soon be without access to non-federal loans that they need to fill the gap left by federal loan limits. And access to even FFEL program loans will become a greater concern with each passing month that the market remains in its current state.

The current market situation directly affects what we can do to serve students and families in our states. The FFEL program has served students and families well for over 40 years. The public-private partnership has led to innovation and commitment by loan providers to supply low cost loans and critical services that help students pursue and complete a higher education. While we can do little or nothing about college costs, we can ensure students have efficient and low cost financing alternatives, and many other services to meet their needs. If my organization ceased to be a partner in the FFEL program, not only would a local mission-based organization vanish and 235 dedicated and service-minded employees be out of a job, but critical services would also be unavailable to our citizens. These include financial literacy programs, college planning, career planning, outreach, debt management programs, teacher and military loan forgiveness programs, and training opportunities for higher education professionals, to name a few. Our organization in South Carolina is both required and honored to serve

students at every school in our state. Our absence would likely produce a disparate impact on different institutions within the state, with students at some schools facing a greater restriction of choice than their peers at other schools.

Much has been discussed about the Lender of Last Resort Program being the solution. It is not, in my view, the answer to the issue before us. This is a capital markets problem and the Lender of Last Resort does not solve the market problem to ensure students continue to have choice in financing their education. The situation in which we find ourselves is not loan providers being unwilling to provide funds to students, it is loan providers being unable to provide loan funds due to the liquidity issues in the market place. While it is prudent for the Department of Education to review current law and its administrative processes, it is far more prudent for us all to work together to do all we can to make sure such a drastic measure is not needed. Students should be able to continue to choose the loan provider of their choice, as choice is a fundamental tenet of the FFEL program. We want to work with the Congress and with Treasury and other Federal agencies to avoid a widespread disruption in both the federal and non-federal student loan programs.

Ensure Choice: The title of this hearing is ensuring the availability of Federal Student Loans. Along with availability, it is important that schools and students continue to have choice in meeting their higher education financing needs. These programs have become more effective overall by allowing choice. Colleges and universities are in the process now of packaging financial aid for the upcoming academic year. We should not ask institutions that have selected the program that best fits the needs of their students to completely change midstream. It is both necessary and possible to do what is necessary to find a common solution to the market issues before us. FFEL program borrowers may have already chosen their loan provider and requiring a move to the Direct Lending Program will be thwarting that choice. Students, parents and institutions are better off with the ability to work with the local, community-based or national organization they desire. If the Direct Loan program is indeed their choice, it should be for reasons other than having no other option at all. While Direct Lending may be the choice of some, it is

not for all and we should be putting students first and shoring up their ability to finance their education in a manner that best meets their needs. We want to continue to work with our partners in the higher education financing community to provide the means for students and their families to pursue their education without concerns regarding student loan availability.

Conclusion and Recommendation: It is clear that this situation is not a byproduct of poor credit quality or flawed underwriting. Issuers are in this position due to no fault of their own, but rather as an unintended consequence of a larger market issue. I believe strongly that timely and limited federal intervention is warranted in this case to restore confidence in this quality asset and the student loan marketplace. The Federal Reserve took action just this week to inject both liquidity and confidence into the mortgage market. It is similarly appropriate and justified for the Federal Government to take the necessary steps to restore stability in this market. Such measures would have positive, immediate and far-reaching implications for students, families and our country.

Therefore, I respectfully ask that the Secretary of Education continue to monitor this situation, utilize her existing authorities, and review access issues facing students across the country. At the same time, it would be prudent for the Secretary of Treasury to take action, as requested by many members of Congress, including Representative Wilson and others on this committee, to serve as a backstop for auction-rate bonds, making clear the Government's commitment to students across the United States. Finally, I ask that members of this committee work with their colleagues on other committees of jurisdiction.

We need to restore not only confidence in the markets, but also the confidence of students, institutions of higher education and student lending partners. In the spirit of cooperation, we can work together during this unexpected and extraordinary time to do what is necessary and what is right. Action taken immediately to address these market issues could prevent a potential shortfall of loan funds to students for the upcoming academic year.

I thank you again for the opportunity to address the Committee and appreciate the willingness of each of you to be here to take the time to hear from me and my colleagues about this most important issue. I am happy to address any questions you may have.