Beyond Title IV: The Emergence of Private Student Loan Lending and a Profit-Driven System

Justin A. DeAngelis*

I. Introduction

College education is a vital rung on the ladder to the American middle class. A college degree has become more valuable as jobs increasingly require advanced skills. Just as more people have begun pursuing higher education, the cost of college has risen, leading students to take on ever-increasing debt burdens.

Federal student aid, beginning with government initiatives like Lyndon Johnson's Great Society and the GI Bill, was once seen as a boon to Americans seeking further education, but now it is insufficient to meet students' educational costs. As a result, students are increasingly relying on private student loans to cover tuition and education expenses.

Private student loans are securitized and bundled as student-loan-asset-backed securities (SLABS) for sale to investors in a process similar to that of mortgage pooling. Advocates of the private-student-loan industry promote the industry's ability to fund students' educational dreams. The industry, however, has come under recent regulatory scrutiny as students lack options for relief when private loans become too burdensome to pay off due to excessive interest rates or unemployment. Furthermore, certain segments of the student population have been disproportionately burdened by private student loans, including minorities and older students.

Investors, in turn, saw the values of student-loan securities plummet following the credit crisis of 2008. High default rates and lax underwriting standards caused the market for SLABS to come to a complete standstill during the crisis. Despite the losses, the market for SLABS has begun to show signs of revival in recent months.

In this Article, I contend that the private-student-loan industry deprives

* Justin A. DeAngelis, Esq. is a 2013 graduate of Suffolk University Law School. Since graduating from law school, he has practiced bankruptcy law representing consumer debtors and currently works in foreclosure prevention. The author would like to thank Professor Kathleen Engel of Suffolk University Law School for all of her assistance and encouragement of this Article. Additionally, the author thanks the editors of the *Suffolk University Law Review* for their hard work.

students of meaningful options for relief and disproportionately affects nontraditional students. After describing the history of, and market for, student loans, I will recommend changes in the law to protect student borrowers from default and high-cost borrowing and to protect investors from a tumultuous market.

II. HISTORY

Historically, students received loans from private parties, charitable organizations, and private trusts.[1] More modern sources of educational funding can be traced to large federal initiatives occurring in the mid- to late-twentieth century. The Servicemen's Readjustment Act of 1944, commonly known as the GI Bill, provided millions of veterans returning from the Second World War with loans for homes and businesses as well as for college.[2] The GI Bill prompted a rapid rise in the number of Americans going to college, with total enrollment rates increasing by fifty percent.[3] Despite the increase in college attendance, the benefits of the GI Bill were limited, as predominantly male veterans enrolled in college and segregation policies in the South prevented black veterans from enrolling in college at the same level as whites.[4]

Lyndon B. Johnson's Great Society and War on Poverty saw a second wave of Americans attending college. In his State of the Union Address in 1965, Johnson declared that "[e]very child must have the best education that this Nation can provide," and committed to guarantee grants and low interest educational loans.[5] The Higher Education Act of 1965 (HEA) provided aid to students from all backgrounds for the first time in American history by providing grants to the needy and low interest loans to students.[6] Title IV of the HEA and subsequent amendments created the Pell Grant, the Federal Family Education Loan (FFEL) program, the William D. Ford Federal Direct

---

1. *See* Kevin C. Driscoll Jr., Note, *Eradicating the "Discharge by Declaration" for Student Loan Debt in Chapter 13*, 2000 U. ILL. L. REV. 1311, 1313-14 (2000) (noting main sources of educational loans prior to 1965).

2. *See* Servicemen's Readjustment Act of 1944, ch. 268, 58 Stat. 284, *repealed by* Act of Sept. 2, 1958, Pub. L. No. 85-857, 78 Stat. 1105; Melissa Murray, *When War Is Work: The G.I. Bill, Citizenship, and the Civic Generation*, 96 CALIF. L. REV. 967, 971-74 (2008) (noting Bill's focus on developing veterans' employment opportunities).

3. John Bound & Sarah Turner, *Going to War and Going to College: Did World War II and the G.I. Bill Increase Educational Attainment for Returning Veterans*, 20 J. LAB. ECON. 784, 785 (2002) (noting increase in veterans' enrollment from 1939 to 1946, and in 1949).

4. ANGELICA CERVENTES ET AL., TG RESEARCH & ANALYTICAL SERVS., OPENING THE DOORS TO HIGHER EDUCATION: PERSPECTIVES ON THE HIGHER EDUCATION ACT 40 YEARS LATER 10 (2005), *available at* http://www.tgslc.org/pdf/hea_history.pdf, *archived at* http://perma.cc/QZB8-ASR2 (noting disproportionately male participation and describing challenges for black veterans seeking benefit from GI Bill).

5. President Lyndon B. Johnson, Annual Message to the Congress on the State of the Union (Jan. 4, 1965), *available at* http://www.presidency.ucsb.edu/ws/index.php?pid=26907, *archived at* http://perma.cc/S4KM-Y9DN.

6. *See* CERVENTES ET AL., *supra* note 4, at 18 (discussing general provisions of HEA).

Loan Program (Direct Loan Program), and the Federal Perkins Loan Program.[7]

FFEL, the original loan program created under the HEA, incentivized lending by private parties by guaranteeing loans in the event of student borrower defaults.[8] By contrast, the Direct Loan Program, created in 1994, lends money directly to student borrowers.[9] Both loan programs provided a variety of different types of loans, including Stafford and PLUS loans, which are fixed-rate loans and can be subsidized or unsubsidized.[10] Subsidized loans are particularly beneficial to students as interest does not begin accruing until loans go into repayment following graduation or departure from school.[11] Perkins student loans are need-based loans, made with federal funds provided to students' academic institutions.[12] In 2010, the Health Care and Education Reconciliation Act eliminated the FFEL program entirely, due to criticisms of the administrative costs paid to industry loan providers, leaving the Direct Loan Program as the sole federal-loan program.[13]

The federal-student-loan program was recently reformed by the passage of Bipartisan Student Loan Certainty Act (BSLCA).[14] The BSLCA, which President Obama signed into law in August 2013, will stabilize rates on student loans made to students borrowing for the 2013-2014 school year.[15] These rates will be locked and will not change over the life of the loan, but under the BSLCA, interest rates on federal loans made in the future will rise if the economy improves, which is expected.[16] Despite placing caps on interest rates, the BSLCA will impose higher interest rates on federal loans made to

7. *See* Higher Education Act of 1965 § 400, 20 U.S.C. § 1070 (2012) (stating purpose of HEA); CERVENTES ET AL., *supra* note 4, at 24, 33, 38, 40 (outlining provisions of Title IV of HEA).

8. *See* CONG. BUDGET OFFICE, CBO PUB. NO. 4101, A CBO STUDY: COSTS AND POLICY OPTIONS FOR FEDERAL STUDENT LOAN PROGRAMS (2010), *available at* http://www.cbo.gov/sites/default/files/03-25-studentloans.pdf, *archived at* http://perma.cc/KK5C-52AZ.

9. *See id.*

10. *See id*.

11. *See id.*

12. *See* Doug Rendleman & Scott Weingart, *Collection of Student Loans: A Critical Examination*, 20 WASH. & LEE J. CIVIL RTS. & SOC. JUST. 215, 220 (2014) (describing Perkins loans).

13. *See* Health Care and Education Reconciliation Act of 2010, Pub. L. No. 111-152, sec. 2201, § 421, 124 Stat. 1029, 1074; William S. Howard, *The Student Loan Crisis and the Race to Princeton Law School*, 7 J.L. ECON. & POL'Y 485, 485 (2011) (noting integration of Student Aid Fiscal Responsibility Act into Health Care and Education Reconciliation Act); Peter Baker & David M. Herszenhorn, *Obama Signs Overhaul of Student Loan Program*, N.Y. TIMES, Mar. 31, 2010, at A14, *available at* http://www.nytimes.com/2010/03/31/us/politics/31obama.html (describing reasons for support of law).

14. Bipartisan Student Loan Certainty Act of 2013, Pub. L. No. 113-28, 127 Stat. 506.

15. *See* Jenna Johnson, *Obama Signs Student Loan Interest Rate Legislation into Law*, WASH. POST (Aug. 9, 2013), http://www.washingtonpost.com/politics/obama-signs-student-loan-interest-rate-legislation-into-law/2013/08/09/98fb0426-00f2-11e3-9711-3708310f6f4d_story.html, *archived at* http://perma.cc/P6EY-2THC (forecasting benefits of law setting interest rates for federal education loans). Under the BSLCA, current interest rates on undergraduate federal loans will be locked at 3.86%, loans made to graduate students will be locked at 5.41%, and loans extended under the PLUS program will be locked at 6.41%. *See id.* (listing changes in interest rates).

16. *See id.* (summarizing BSLCA).

borrowers in the future.[17] The BSLCA requires current low interest rates to be offset by higher rates over a ten-year period, meaning that future student borrowers will subsidize earlier, cheaper loans.[18] Under the BSLCA, the balancing of interest rates is intended to avoid an impact on the budget, despite the fact that the federal student loan program remains highly profitable to the government.[19]

III. SALLIE MAE

Sallie Mae is the student loan industry giant that has acted in different capacities as a lender, servicer, guarantor, and purchaser of both federal and private loans for over forty years.[20] The company evolved from humbler roots as a government sponsored enterprise (GSE).[21] The Student Loan Marketing Association (SLMA) was created as part of the Higher Education Act Amendment of 1972 to facilitate lending in the FFEL program.[22] SLMA functioned much like the mortgage GSE giants, Fannie Mae and Freddie Mac, by purchasing loans from private lenders participating in the FFEL program.[23] SLMA's role as a GSE created a secondary marketplace by purchasing loans from primary lenders, who then used sale proceeds to make new loans directly to students.[24]

SLMA's GSE status provided SLMA with funding advantages to facilitate student-loan lending.[25] GSEs raise money by issuing securities and use those proceeds to finance a public interest need. As a GSE, SLMA benefited from the perception that the government would not allow an organization fulfilling an important public policy goal to fail. Additionally, SLMA's GSE status allowed it to provide funding to lenders in much larger amounts and operate at a national level, as contrasted with regionally based student-loan lenders.

17. *See* Christine Lindstrom, *The Good, the Bad, and the Ugly in the Student-Loan Deal*, CHRON. HIGHER EDUC. (Aug. 8, 2013), http://chronicle.com/article/The-Good-the-Badthe/141011/, *archived at* http://perma.cc/RPX9-4YWZ (describing effect of BSLCA). The BSLCA caps maximum interest rates at 8.25% for undergraduate Stafford loans, 9.5% for graduate Stafford loans, and 10.5% for PLUS loans. *See id.*

18. *See id.* ("[L]ow interest rates . . . now must be balanced by higher rates down the road.").

19. *See id.* (noting Senator Elizabeth Warren's estimate of $184 billion in government profits over next decade).

20. *See* Bethany McLean, *When Sallie Met Wall Street*, FORTUNE (Dec. 26, 2005), http://archive.fortune.com/magazines/fortune/fortune_archive/2005/12/26/8364649/index.htm, *archived at* http://perma.cc/C76M-W57X (explaining Salle Mae's origins and development).

21. *See id.* (describing creation of Sallie Mae); ERIN DILLON, EDUC. SECTOR, AM. INSTS. FOR RESEARCH, LEADING LADY: SALLIE MAE AND THE ORIGINS OF TODAY'S STUDENT LOAN CONTROVERSY 3 (May 2007), *available at* http://www.educationsector.org/sites/default/files/publications/SallieMae.pdf, *archived at* http://perma.cc/WJK9-3TEX (noting benefits received by Sallie Mae as GSE).

22. *See* CERVENTES ET AL., *supra* note 4, at 24, 34 (describing Sallie Mae as secondary market in program precursor to FFEL program).

23. *See* DILLON, *supra* note 21, at 3 (describing Sallie Mae's purpose alongside other GSE's).

24. *See id.*

25. *See id.*

Despite these advantages, SLMA's charter as a GSE restricted it from engaging in certain business activities, such as primary lending to borrowers and marketing other financial products.[26]

The 1980's and 90's proved very profitable for SLMA. In 1983, the GSE began issuing publically traded stock that provided for an additional source of revenue beyond government funding.[27] Additionally, in 1986, the Department of Education promulgated stringent regulations regarding lending, requiring lenders to provide processing and collection services for loan payments.[28] Lenders that failed to comply would lose the federal repayment guarantee.[29] Smaller lenders were often unable to meet the costs imposed by the regulations, prompting many to sell their loans or outsource their servicing needs to larger industry participants like SLMA.[30] The additional regulatory burdens also prevented new lenders and servicers from entering the market, creating a concentration of large players, with SLMA leading the pack.[31] Also contributing to the rapid growth of SLMA was the reauthorization of the HEA by Congress in 1992, which created unsubsidized loans available to students regardless of family income. These changes, in addition to the rising college costs of the 1990's, fueled SLMA's growing business.[32]

SLMA sought fully independent status in 1993, prompted by educational reforms initiated under the Clinton Administration.[33] The Omnibus Budget and Reconciliation Act (the Act) proposed to shift federal student lending almost entirely under the Direct Loan Program.[34] The Act would have relegated SLMA to "lender of last resort" status for students attending institutions that were ineligible for the Direct Loan Program due to high default rates. Furthermore, the Act would have charged fees on loans held under the FFEL program, costs that served to all but eliminate SLMA's funding advantage as a GSE.[35] Ultimately the Act was not successful in phasing out the FFEL program, but the Act posed a political risk to SLMA's business that caused the GSE's share price to drop sharply.[36] This risk, as well as the ambition to pursue business opportunities unavailable to GSEs, led SLMA to seek

26. *See id.*
27. *See* DILLON, *supra* note 21, at 4.
28. *See id.*
29. *See id.*
30. *See id.*
31. *See* DILLON, *supra* note 21, at 4.
32. *See id.* at 5.
33. *See id.* at 6.
34. *See* Omnibus Budget Reconciliation Act of 1993, Pub. L. No. 103-66, sec. 4021, tit. IV, § 451-58, 107 Stat. 312, 341-54; DILLON, *supra* note 21, at 6.
35. *See* DILLON, *supra* note 21, at 6.
36. *See* OFFICE OF SALLIE MAE OVERSIGHT, U.S. DEP'T OF THE TREASURY, LESSONS LEARNED FROM THE PRIVATIZATION OF SALLIE MAE 8 (drft. 2006), *available at* http://www.treasury.gov/about/organizational-structure/offices/Documents/SallieMaePrivatizationReport.pdf, *archived at* http://perma.cc/9ZJH-M7C3 (describing investors' concerns).

privatization.[37]

In 1996, the Student Loan Marketing Association Reorganization Act (the Reorganization Act) provided SLMA with Congressional approval to shed its GSE status.[38] The Reorganization Act created a holding company that would own both the existing GSE and a new independent corporation known as Sallie Mae.[39] The GSE would continue to provide secondary market funding for student loan lenders until 2008; the entity was dissolved early, however, in 2004.[40] The reorganization allowed the new, private Sallie Mae to engage in business practices outside of the limited charter of a GSE, most notably as a primary-student-loan-lender.[41]

IV. TERMINATION OF THE FFEL PROGRAM

In 2010, the passage of the Healthcare and Education Reconciliation Act (Healthcare and Education Act) terminated the FFEL program and lending by private institutions under the auspices of Title IV.[42] Following the Healthcare and Education Act, the government ceased paying fees to private lenders and began originating loans directly from the Department of Education through the Direct Loan Program.[43] Private lenders previously participating in the FFEL program fiercely opposed passage of the Healthcare and Education Act.[44] Beginning in 2009, Sallie Mae and other industry players commenced an extensive, but ultimately unsuccessful, lobbying campaign to protect business arising from their participation in the FFEL program.[45]

The Healthcare and Education Act eliminated Sallie Mae's largest source of income.[46] Regulatory filings and press releases have outlined a business model that Sallie Mae now pursues.[47] Private-student-loan lending is a key aspect of Sallie Mae's business. Unlike lending by private institutions participating in

37. *See id.*

38. *See* Student Loan Marketing Association Reorganization Act of 1996, Pub. L. No. 104-208, tit. VI, 110 Stat. 3009, 3009-275 to 3009-293 (codified as amended in scattered sections of 20 U.S.C.).

39. *See* DILLON, *supra* note 21, at 6-7 (describing split of Sallie Mae into GSE and non-GSE entities).

40. *See id.* at 7.

41. *See id.* at 6-7.

42. *See* Health Care and Education Reconciliation Act of 2010, Pub. L. No. 111-152, secs. 2201-13, 124 Stat. 1029, 1074-81 (codified in scattered sections of 20 U.S.C.); Baker & Herszenhorn, *supra* note 13.

43. *See* Baker & Herszenhorn, *supra* note 13.

44. *See* Eric Lichtblau, *Lobbying Imperils Overhaul of Student Loans*, N.Y. TIMES (Feb. 4, 2010), http://www.nytimes.com/2010/02/05/us/politics/05loans.html?pagewanted=all (explaining private lenders' attempts to lobby against Act).

45. *See id.*

46. *See* SLM CORP., ANNUAL REPORT (FORM 10-K) 33 (Feb. 26, 2013), *available at* http://www.sec.gov/Archives/edgar/data/1032033/000119312513076990/d440039d10k.htm, *archived at* http://perma.cc/U8N9-6ZQY.

47. *See* John Hechinger & Janet Lorin, *Sallie Mae Split Marks Bet on Abused Private Student Loans*, BLOOMBERG (May 31, 2013), http://www.bloomberg.com/news/articles/2013-05-31/sallie-mae-split-marks-bet-on-much-abused-private-student-loans, *archived at* http://perma.cc/8KVK-QZPT.

the FFEL program, private student loans are made between a private lender to a borrower and do not include the government as a participant in any capacity. Sallie Mae is the largest lender of private student loans.[48] Additionally, Sallie Mae also retains a large business as a student loan servicer for both the Direct Loan Program and legacy FFEL loans.[49] Sallie Mae purchases legacy FFEL loans because they continue to generate income through borrower payments.[50]

V. EMERGENCE OF THE PRIVATE STUDENT LOAN INDUSTRY

In the 1980's, lenders began making private student loans, although the overall market share remained very limited in comparison to federal-student-loan programs. Early private student loan lending was largely directed at professional students, studying fields like law and medicine, who were considered more likely to repay.[51] During this period, private-student-loan lenders lacked the ability to compete with federal loans because students were attracted by low interest loans under the FFEL program, the emergence of a new class of loans available to parents under the federal PLUS program, and difficulties private industry faced raising capital.

Private lending began to grow in the mid 1990's due to rapidly increasing college costs and lenders' ability to target different segments of students. According to the College Board, by the 1999-2000 academic year, total private lending exceeded $3.8 billion dollars per year, and while this number represented a small part of overall student lending, it represented a nearly 300% increase since the 1995-1996 academic year.[52]

Private loans were made in conjunction with federal loans through university financial aid offices until 2008.[53] A lender could distinguish itself by landing on a school's "preferred lender" list if it offered private loans as part of aid packages that included loans through the FFEL program.[54] In 2008, the Higher Education Opportunity Act largely put an end to private lenders preferential

48. *See* SLM CORP., *supra* note 46, at 35.

49. *See id*.

50. *See* Press Release, Sallie Mae, Sallie Mae Reports First-Quarter 2012 Financial Results (Apr. 18, 2012), *available at* http://news.salliemae.com/press-release/corporate-and-financial/sallie-mae-reports-first-quarter-2012-financial-results, *archived at* http://perma.cc/XU7D-DACS.

51. INST. FOR HIGHER EDUC. POLICY, THE FUTURE OF PRIVATE LOANS: WHO IS BORROWING, AND WHY? 5 (2006), *available at* http://www.ihep.org/assets/files/publications/a-f/futureprivateloans.pdf, *archived at* http://perma.cc/C3V5-9ZCN.

52. COLL. BD., TRENDS IN STUDENT AID 3 (2000), *available at* http://trends.collegeboard.org/sites/default/files/SA_2000.pdf, *archived at* http://perma.cc/P57W-C6EZ (providing data on private education loans in 1990s-2000s).

53. *See* Higher Education Opportunity Act, Pub. L. No. 110-315, sec. 1011(a), § 140, 122 Stat. 3078, 3479-81 (2008) (codified at 15 U.S.C. § 1650); CONSUMER FIN. PROT. BUREAU, PRIVATE STUDENT LOANS 11 (2012), *available at* http://files.consumerfinance.gov/f/201207_cfpb_Reports_Private-Student-Loans.pdf, *archived at* http://perma.cc/3RGU-MN7H [hereinafter CFPB].

54. *See* CFPB, *supra* note 53, at 11.

treatment by financial aid offices by requiring burdensome standards to be met for the recommendation of private loans.[55]

Private-student-loan lenders employ underwriting criteria before making loans to borrowers. Underwriting requirements include an evaluation of a borrower's income and credit history and often require a co-signer, especially if the primary borrower is an undergraduate student with a limited credit history.[56] Underwriting standards became significantly more rigorous following the credit crisis of 2008.[57] Prior to the crisis, and during a period of explosive growth and profits in the private student loan industry, many loans were made to borrowers who lacked the means to repay them.[58] A notable difference between federal and private loans is that federal student loans do not stipulate underwriting standards that a borrower must meet.[59]

VI. THE LENDERS

By 2012, outstanding private-student-loan debt exceeded $150 billion, which represented about fifteen percent of all student debt.[60] Private student loans are made by a variety of parties, including financial institutions, for-profit education companies, nonprofit organizations, and state agencies.[61] In contrast to loans formerly made by private lenders under the FFEL program, private student loans have never received any government guarantee of repayment.[62] The largest lenders include leading financial institutions like Sallie Mae, Wells Fargo, PNC Financial, and Sun Trust, with Sallie Mae originating almost fifty percent of new loans and representing the largest lender by a wide margin.[63]

Private lenders market student loans as providing benefits like "competitive interest rates," "choice of repayment options," and even have rewards programs

55. *See* Higher Education Opportunity Act, Pub. L. No. 110-315, sec. 493 (c), § 487, 122 Stat. 3078, 3309-17 (2008) (codified as amended at 20 U.S.C. § 1094).

56. *Important Information About Private Student Loans*, SALLIE MAE, https://www.salliemae.com/student-loans/information.aspx (last visited Feb. 3, 2015), *archived at* https://perma.cc/ET5S-W6ME.

57. *See* DEANNE LOONIN, NAT'L CONSUMER LAW CTR., TOO SMALL TO HELP: THE PLIGHT OF FINANCIALLY DISTRESSED PRIVATE STUDENT LOAN BORROWERS 7 (2009), *available at* http://www.studentloanborrowerassistance.org/wp-content/uploads/2013/05/TooSmalltoHelp.pdf, *archived at* http://perma.cc/9JVM-7N8H.

58. *See id.* at 5.

59. *See generally id.*

60. ROHIT CHOPRA, CONSUMER FIN. PROT. BUREAU, ANNUAL REPORT OF THE CFPB STUDENT LOAN OMBUDSMAN 2 (2012), *available at* http://files.consumerfinance.gov/f/201210_cfpb_Student-Loan-Ombudsman-Annual-Report.pdf, *archived at* http://perma.cc/ERN4-SDMJ.

61. *See* INST. FOR HIGHER EDUC. POLICY, *supra* note 51, at 5.

62. *See id.*

63. Adom J. Rosengarten & Vikas C. Jhaveri, *Unsustainable Conditions: The Evolving Market for Private Student Lenders*, 32 CREDIT WEEK, no. 32, 2012, at 9, 11, *available at* http://www.standardandpoors.com/spf/swf/ereports/webpage/Webpage/pdf/cWk_08292012_FluidBook.pdf, *archived at* http://perma.cc/LMR9-ZFEX.

for borrowers who make timely payments.[64] Private loans, however, generally provide student borrowers with a low quality alternative to federal loans under Title IV.[65] The vast majority of the time, private student loans are more expensive than federal loans because interest on these loans is calculated using a variable rate tied to an index like the London Interbank Offered Rate (LIBOR).[66] Federal loans charge fixed interest rates, which are capped depending on the type of loan borrowed.[67]

Lenders have sought to maximize interest rates on private loans by channeling loans through different companies, subject to different laws. In 2005, Sallie Mae purchased private loans made to students at Lehigh Valley College, a for-profit college in Pennsylvania.[68] The loans were initially made by Stillwater National Bank (Stillwater), a small Oklahoma bank, and the loans carried rates up to twenty-one percent.[69] Sallie Mae originally marketed the loans to Lehigh Valley students at interest rates of thirteen percent.[70] A Sallie Mae executive later stated in a hearing before the Pennsylvania House Consumer Affairs Bureau that originating loans from Stillwater allowed Sallie Mae to charge interest rates of up to twenty-one percent under Oklahoma law, while in Pennsylvania, the law capped the rates at eighteen percent.[71]

Sallie Mae's relationship with Stillwater has recently been questioned in a class action lawsuit filed by California plaintiffs.[72] The lawsuit alleges that Sallie Mae made private loans in violation of California's consumer protection laws by funneling loans through Stillwater.[73] The Federal District Court for the Northern District of California denied Sallie Mae's motion to dismiss for failure to state a claim, and the court permitted discovery to address whether Sallie Mae was the "de facto lender" to the California borrowers.[74] The plaintiffs asserted that Stillwater did no more than "rent out" its bank charter to Sallie Mae, who originated funding for the private loans.[75]

64. *Undergraduate Smart Option Student Loan*, SALLIE MAE, https://www.salliemae.com/student-loans/smart-option-student-loan/ (last visited Feb. 1, 2015), *archived at* https://perma.cc/7VQN-UFDB.

65. *See* LOONIN, *supra* note 57, at 2. ("[T]he bottom line is that private loans are almost always more expensive.").

66. *See* INST. FOR HIGHER EDUC. POLICY, *supra* note 51, at 5.

67. *See* LOONIN, *supra* note 57, at 2 (explaining federal loan interest caps compared to private loans).

68. *See* McLean, *supra* note 20 (describing particular Sallie Mae private loan purchase).

69. *See id.*

70. *See id.*

71. *See id.*

72. *See* Ubaldi v. SLM Corp., 852 F. Supp. 2d 1190, 1191-92 (N.D. Cal. 2012) (reciting plaintiff's theory).

73. *See id.* at 1191-92 (outlining plaintiff's allegations).

74. *See id.* at 1203 (stating court's rulings).

75. *See id.* at 1195.

VII. FOR-PROFIT INSTITUTIONAL PRIVATE LENDING

For-profit education companies have become key players in the private lending industry. These education companies are businesses that provide seemingly convenient educational programs to largely nontraditional students.[76] Pursuant to their corporate structure, for-profit institutions must answer to shareholders. In 2009, at least seventy-six percent of students enrolled in for-profit institutions attended an institution that was either publicly traded or owned by a private equity firm.[77]

The for-profit model depends on federal financial aid under Title IV. Many companies receive up to ninety percent of their tuition revenue from the government.[78] Federal law, under a regulation called the 90/10 Rule, requires that for-profit institutions receive at least ten percent of tuition dollars from sources other than Title IV funds.[79] To meet the requirements of the 90/10 rule, for-profit institutions often offer institutional loans or private loans made directly by the institution to students.[80] Known as "loss leaders," these institutional loans face high default rates by students.[81]

VIII. STUDENT LOANS AND BANKRUPTCY

In 1998, Congress exempted Title IV loans from discharge under the Bankruptcy Code, except in the case of undue hardship.[82] A few years later, Congress passed the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA), which afforded private lenders the same bankruptcy protections as the federal government. With the stated purpose of "restoring personal responsibility and integrity in the bankruptcy system," BAPCPA amended the bankruptcy code to prevent the discharge of qualified education loans.[83] The limited "undue hardship" exception provided to debtors seeking to

---

76. S. COMM. ON HEALTH, EDUC., LABOR, & PENSIONS, 112TH CONG., REP. ON FOR PROFIT HIGHER EDUCATION: THE FAILURE TO SAFEGUARD THE FEDERAL INVESTMENT AND ENSURE STUDENT SUCCESS 2 (Comm. Print 2012), *available at* www.gpo.gov/fdsys/pkg/CPRT-112SPRT74931/pdf/CPRT-112SPRT74931.pdf, *archived at* http://perma.cc/AR6Q-XRWJ (commenting flexibility of for-profit colleges appeared well-suited for nontraditional students).

77. *See id.* at 17.

78. Emily Richmond, *If Colleges Want Federal Funds, They'll Have To Prove Students Get Jobs*, THE ATLANTIC (June 27, 2012), *available at* http://www.theatlantic.com/national/archive/2012/06/if-colleges-want-federal-funds-theyll-have-to-prove-students-get-jobs/259038/, *archived at* http://perma.cc/8E85-U8XD.

79. *See* 34 C.F.R. § 668.28 (2015).

80. DEANNE LOONIN & JILLIAN MCLAUGHLIN, NAT'L CONSUMER LAW CTR., STATE INACTION: GAPS IN STATE OVERSIGHT OF FOR-PROFIT HIGHER EDUCATION 11-12 (2011), *available at* http://www.studentloanborrowerassistance.org/wp-content/uploads/2013/05/state-inaction-for-profit-higher-edu.pdf, *archived at* http://perma.cc/YD8H-PQFF.

81. *See id.* at 11.

82. *See* Educ. Credit Mgmt. Corp. v. Jesperson, 571 F.3d 775, 778 (8th Cir. 2009) (reviewing history of provisions for nondischargeability of federal student loans).

83. *See* Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, § 220, 119 Stat. 23, 59 (codified at 11 U.S.C. § 523(a)); H.R. REP. NO. 109-31(I), at 1-2 (2005), *reprinted in* 2005

discharge federal loans is now the only option available to discharge private loans as well.[84]

BAPCPA's expansive student loan exemption resulted from years of lobbying by the private-student-loan industry.[85] Sallie Mae alone spent $9 million on lobbying between 1999 and 2005.[86] The amendment followed a trend toward restricting bankruptcy protections for borrowers that began in the 1980s based on a widely held perception that many borrowers were taking out student loans with no intention of repaying them. It is noteworthy that the justification for borrower "personal responsibility and integrity" was at odds with a declining student loan default rate, which decreased to a low of four and a half percent in 2003 from twenty-two percent in 1990.[87]

IX. THE BORROWERS

Private student loans are disproportionately concentrated among low- to middle-income students who study at for-profit educational institutions. According to Consumer Financial Protection Bureau (CFPB) data, during the 2007-2008 academic year, approximately fourteen percent of undergraduate students and eleven percent of graduate and professional students acquired private student loans. The highest levels of borrowing occurred among students aged nineteen to twenty-nine.[88] The CFPB considered the borrowers' parental income, analyzing loan debt among the four quartiles of family income from highest to lowest. The highest percentage of borrowers fell within the third quartile.[89] Borrowers from the fourth quartile had the largest loans on average.[90]

Borrowers attending for-profit institutions were the most likely to have both private and federal loans, including forty-six percent of students at four-year-for-profit institutions.[91] Students at for-profit institutions were also the most likely to have federal loans and the least likely to have no student debt burden

U.S.C.C.A.N. 88, 88-89 (stating purpose of Act).

84. *See Jesperson*, 571 F.3d at 778; *see also* Mark Kantrowitz, *Impact of the Bankruptcy Exception for Private Student Loans on Private Student Loan Availability*, FINAID (Aug. 14, 2007), http://www.finaid.org/educators/20070814pslFICOdistribution.pdf, *archived at* http://perma.cc/6EDB-RVE9.

85. Interview by Robert Siegel with Stephen Burd, Senior Research Fellow, New Am. Found, on National Public Radio (Apr. 24, 2007), *available at* http://www.npr.org/templates/transcript/transcript.php?storyId=9803213.

86. *Id.*

87. FED. STUDENT AID, U.S. DEP'T OF EDUC., *National Student Loan Two-year Default Rates: FY 2011 2-Year National Student Loan Default Rates*, http://www2.ed.gov/offices/OSFAP/defaultmanagement/defaultrates.html, *archived at* https://perma.cc/99BD-U4R8.

88. *See* CFPB, *supra* note 53, at 38-41.

89. *See id.* at 42-46.

90. *See id.*

91. *See id.* at 47.

whatsoever.[92] Additionally, the percent of students taking out private loans to pay for a for-profit education increased from fourteen percent during the 2003-2004 academic year to over forty percent by 2007-2008.[93]

For-profit institutions primarily serve non-traditional student groups that may not otherwise be able to attend college.[94] Most students are above the age of twenty-five, fifty percent are minorities, and approximately thirty percent are single parents.[95] Troublingly, students at for-profit institutions are also the most likely to over-borrow or borrow in excess of tuition and fees.[96] Further, the convenience of programs often draws students to pursue for-profit schools, which includes extensive online course offerings, multiple locations, and the ability for students to delay and resume their education.[97] The for-profit education industry markets these features extensively. The high prevalence of private lending occurring within the confines of for-profit institutions and the nontraditional, low-income student body suggest that private student loans have a disproportionate impact on at-risk student populations.[98]

Older nontraditional students are increasingly taking on both federal and private debt. For example, student loan debt among borrowers above the age of sixty is currently growing the fastest among all demographic groups, and today, over two million borrowers in that age group owe an average of $19,000 in loans.[99] The increase in borrowing among older students is attributed to the weak economy and workers obtaining educational qualifications in hopes of revitalizing their careers. Unlike their younger counterparts, these borrowers typically lack the prospect of long careers to pay back their loans, and when they default, lenders often garnish their wages or social security payments.[100]

One of the most troubling findings related to private loans is that most borrowers take out private loans prior to exhausting safer federal options under Title IV.[101] By exhausting federal loan sources before acquiring private loan debt, a borrower can maximize subsidized loans that do not accrue interest

92. *See* CFPB, *supra* note 53, at 47.

93. *See id.* at 39; *see also* NAT'L CONSUMER LAW CTR., RESPONSE TO THE CONSUMER FINANCIAL PROTECTION BUREAU'S REQUEST FOR INFORMATION REGARDING AN INITIATIVE TO PROMOTE STUDENT LOAN AFFORDABILITY 4 (Apr. 8, 2013), ***available at*** http://www.studentloanborrowerassistance.org/wp-content/uploads/2007/03/cfpb-comments-april2013.pdf, *archived at* http://perma.cc/X2KG-MSZ7.

94. *See* Anthony J. Guida Jr. & David Figuli, *Higher Education's Gainful Employment and 90/10 Rules: Unintended "Scarlet Letters" for Minority, Low-Income, and Other At-Risk Students*, 79 U. CHI. L. REV. 131, 131-32 (2012) (describing student body composition of for-profit institutions).

95. *See* Guida & Figuli, *supra* note 94, at 140-42.

96. *See* MARK KANTROWITZ, BORROWING IN EXCESS OF INSTITUTIONAL CHARGES 9 (2011), *available at* http://www.finaid.org/educators/20110428debtbeyondtuition.pdf, *archived at* http://perma.cc/5TPS-4L9E.

97. *See* Guida & Figuli, *supra* note 94, at 140-42 (describing attractiveness of proprietary schools).

98. *See* CHOPRA, *supra* note 60, at 6.

99. *See* Stacey Patton, *I Fully Expect To Die With This Debt*, CHRON. HIGHER EDUC. (Apr. 15, 2013), http://chronicle.com/article/I-Fully-Expect-To-Die-With/138507, *archived at* http://perma.cc/G8DJ-D6KB.

100. *See id.*

101. *See* CFPB, *supra* note 53, at 50-51.

while they are enrolled in school at least part time. Borrowers' decisions to use private loans may be the result of confusion. For example, there is evidence that borrowers take out private loans under the incorrect assumption that they are federal loans or believe that such loans offer better terms, such as a lower interest rate.[102] The variable interest rates charged on private loans, however, means that borrowers may pay much higher rates during repayment.[103]

Another source of confusion that may lead borrowers to inadvertently take out private loans is the Free Application for Federal Student Aid (FAFSA), which students must file to borrow from the government. The FAFSA is a lengthy form requiring students and parents to provide detailed income and tax information. FAFSA instructions are inconsistent with the income calculation methodology under the tax code, which can result in the calculation of higher adjusted gross income and expected family contribution. In addition, the FAFSA requires borrowers to submit information from their W-2 form without indicating the box where such information can be found.[104] Lastly, some borrowers submit applications to a financial aid preparation business using the web domain FAFSA.com, believing that they are filing a FAFSA with the government. As a result, borrowers sometimes submit erroneous information or fail to file a FAFSA, which can miscalculate a federal aid award or even render a borrower ineligible altogether.[105]

Unlike federal loans that provide a nine-month safety period before default, private loans go into default when a borrower misses a single payment.[106] Some private loan contracts stipulate that a borrower goes into default if a borrower dies, experiences a "lessening of your ability to repay" in the lenders' judgment, defaults on any other loan made by the lender, or files for bankruptcy.[107] While limited statistics are available, borrower default is commonly associated with unemployed or underemployed borrowers who lack a familial network capable of providing assistance.[108] Borrowers in default

102. *See id.* at 11-12.

103. *See id*.

104. *See Income Earned from Work*, FINAID, http://www.finaid.org/fafsa/earnedincome.phtml (last visited Feb. 2, 2015), *archived at* http://perma.cc/46UM-6XQ9.

105. *See* Noelia De La Cruz, *Students Looking for FAFSA.gov Are Mistakenly Going to FAFSA.com*, BUS. INSIDER (Mar. 6, 2012), http://articles.businessinsider.com/2012-03-06/news/31125555_1_fafsa-free-application-federal-student-aid, *archived at* http://perma.cc/4X8Y-8XF8.

106. *See Federal Loans: Default and Delinquency*, STUDENT LOAN BORROWER ASSISTANCE, http://www.studentloanborrowerassistance.org/default-and-delinquency/ (last visited Feb. 2, 2015), *archived at* http://perma.cc/P26P-PZ75.

107. *See Private Loans: Default and Delinquency*, STUDENT LOAN BORROWER ASSISTANCE, http://www.studentloanborrowerassistance.org/collections/private-loans/default-and-delinquency/ (last visited May 25, 2015), *archived at* http://perma.cc/HH4U-ZFC6.

108. *See* DEANNE LOONIN, NAT'L CONSUMER LAW CTR., THE STUDENT LOAN DEFAULT TRAP: WHY BORROWERS DEFAULT AND WHAT CAN BE DONE 3, 11-12 (2012), *available at* http://www.studentloanborrowerassistance.org/wp-content/uploads/2013/05/student-loan-default-trap-report.pdf, *archived at* http://perma.cc/EZ99-GCBC.

very often do not finish the degree program for which they borrowed. As one would expect, for-profit colleges have the highest rate of former students in default.[109]

Default has life-long repercussions for borrowers. Private lenders often employ debt collectors and bring lawsuits to recover borrowers' debts.[110] The effects on borrowers' credit may prevent them from starting families, buying homes, or finding employment. Further, these proceedings undoubtedly cause stress and emotional trauma for borrowers.

Borrowers in default on private student loans face aggressive collection efforts and have few resources for assistance and advocacy. Further, following BAPCPA, bankruptcy discharge rarely provides relief to borrowers.[111] Additionally, protections available for federal borrowers, like income-based repayment, loan modifications, and rehabilitation, are typically not available to private-student-loan borrowers.[112] Loan cancellations for death and disability, which are available for federal loans, are offered at the discretion of private lenders.[113] The unequal and vulnerable position of borrowers in default of private student loans raises troubling concerns about unfair terms and practices employed by lenders.

X. SECURITIZATION

Securitization is the creation of investment securities backed by the interest and principal from loans.[114] A financial institution purchases the loans and pools them. They are then sold to an issuer who issues bonds backed by the pool of loans. The issuing institution often creates different tranches within the loan pool or bonds with varying maturity dates, priority of payment, and interest rates. The pooling of loans and subsequent sale to investors allows lenders to protect themselves against borrower default as investors, who bear the primary risk of resulting losses from the loan portfolio, purchase the securities.[115]

109. *See id.* at 11-13.

110. *See Private Loans*, STUDENT LOAN BORROWER ASSISTANCE, http://www.studentloanborrowerassistance.org/collections/private-collections/ (last visited Feb. 2, 2015), *archived at* http://perma.cc/VL2H-PSYU (explaining time limit for private student loan collection). Private collectors do not have as many collection tools as collectors of government loans. *See id.*

111. *See* NAT'L CONSUMER LAW CTR., *supra* note 93, at 16.

112. *See id.* at 14-16.

113. *See id.* at 17.

114. *See* Steven L. Schwarcz, *The Alchemy of Asset Securitization*, 1 STAN. J.L. BUS. & FIN. 133, 135-36 (1994) (explaining securitization).

115. Asset backed securities often include credit enhancement features, such as reserve accounts, overcollateralization, and subordination, to offset losses when borrowers default. Reserve accounts contribute to interest and principal payments when collateral loans default. Overcollateralization occurs when trust assets exceed 100% of the market value of notes issued. Different classes of notes are subordinated to provide risk-averse investors with more protection. *See Navient Student Loan Trusts 2006*, NAVIENT, http://www.navient

In the context of consumer lending, the term "asset-backed securities" (ABS) usually refers to bonds backed by mortgages, credit card receivables, auto loans, or student loans. Student-loan-asset-backed securities (SLABS) are a subcategory of the ABS market and are backed by nondischargeable-student-loan notes.[116] Student loan auction rate securities (SLARS) represent another student loan related security.[117] With SLARS, the interest rates on the bonds are reset periodically in auctions held by brokers. Bids by investors seeking to hold the SLARS determine the interest rate.[118]

The securitization of student loans first occurred in November 1992 following the passage of Rule 3(a)(7) of the Investment Company Act of 1940, which exempted issuers of ABS from registration as investment companies.[119] Prior to the exemption, the issuance of ABS was greatly restricted. Issuers of ABS previously fell within the definition of an investment company because, under the Act, they issued securities and primarily engaged in the investing in, owning or holding of securities.[120] Registration as an investment company subjected issuers of ABS to restrictions on "capital structure and limitations on transactions with affiliates."[121] These requirements were difficult for ABS issuers to meet due to the layered structure of bonds and multiple parties involved in the securitization process.[122] The 1992 exemption allowed issuers to avoid registration under the Act if: fixed income securities were issued; a trust obtained certain credit ratings; and a trustee held the loans.[123] Beginning in the 1990's, the exemption of issuers from registration as an investment

.com/about/investors/debtasset/slmsltrusts/historicalreports2006/ (last visited Feb. 3, 2015), *archived at* http://perma.cc/943H-23H6. *See generally* SALLIE MAE, INC., PROSPECTUS SUPPLEMENT TO BASE PROSPECTUS DATED JUNE 1, 2006: SLM PRIVATE CREDIT STUDENT LOAN TRUST 2006-B (2006), *available at* https://www.navient.com/assets/about/investors/debtasset/SLM-LoanTrusts/06-10/2006-B/2006B.pdf, *archived at* https://perma.cc/GE3E-TF9A; SALLIE MAE, INC., PROSPECTUS SUPPLEMENT TO BASE PROSPECTUS DATED MARCH 31, 2006: SLM PRIVATE CREDIT STUDENT LOAN TRUST 2006-A (2006), *available at* https://www.navient.com/assets/about/investors/debtasset/SLM-Loan-Trusts/06-10/2006-A/2006A.pdf, *archived at* https://perma.cc/5MFY-VDDY [hereinafter SALLIE MAE, INC., TRUST 2006-A]; SALLIE MAE, INC., PROSPECTUS SUPPLEMENT TO BASE PROSPECUTS DATED SEPTEMEBER 20, 2006: SLM PRIVATE CREDIT STUDENT LOAN TRUST 2006-C (2006), *available at* https://www.navient.com /assets/about/investors/debtasset/SLM-Loan-Trusts/06-10/2006-C/2006C.pdf, *archived at* https://perma.cc /QEM7-Z6TR.

116. *See* CFPB, *supra* note 53, at 18.

117. *See* D. ANDREW AUSTIN, CONG. RESEARCH SERV., RL34672, AUCTION-RATE SECURITIES 1, 12 (2012), *available at* http://www.fas.org/sgp/crs/misc/RL34672.pdf, *archived at* http://perma.cc/9JAE-2E56.

118. *See id.* at 1, 12.

119. *See* Frank Tallerico & Ivan Gjaja, *Student Loans*, *in* SALOMON SMITH BARNEY: GUIDE TO MORTGAGE-BACKED AND ASSET-BACKED SECURITIES 692, 703 (Lakhbir Hayre ed., 2001).

120. *Compare* Investment Company Act of 1940, ch. 680, § 3(a), 54 Stat. 789, 797 (defining investment company as "any issuer which . . . [is] engaged primarily . . . in the business of investing, reinvesting, or trading in securities"), *with* 17 C.F.R. § 270.3a-7 (1992) (exempting ABS issuers from investment company registration requirement).

121. *See* PATRICK D. DOLAN & C. VANLEER DAVIS III, SECURITIZATIONS: LEGAL AND REGULATORY ISSUES § 3.03 (2001).

122. *See id.*

123. *See* 17 C.F.R. § 270.3a-7.

company caused a large increase in the securitization of loans.[124]

Lenders' ability to transfer ownership of student loans allows them to raise cash from investors and finance new loans. The ability to securitize also allows lenders to avoid expensive short-time financing to make loans.[125] Additionally, the securitization process encourages lenders to maximize the number of loans they make because securitization deals require a minimum volume of loans and larger issuances lead to larger profits due to economies-of-scale.[126]

During 2006, at the peak of the securitization era, Sallie Mae transferred private student loans with principal amounts exceeding $5.5 billion into three different trusts.[127] As Sallie Mae regulatory filings reflect, this complex process involved multiple legal entities, structured financing, and derivative hedging.[128] The parties involved in the securitization process and trust mechanisms are described below in reference to the SLM Private Credit Student Loan Trusts 2006-A, 2006-B, and 2006-C.[129]

Sallie Mae, as the trusts' sponsor, securitized student loans by transferring the loans to trusts that issued securities.[130] The trustee was given legal title to the trust assets—which were the student loans made by Sallie Mae. Following the transfer of loans to the trust and the issuance of securities, the trustee sold the bonds to underwriters or large Wall Street investment banks in blocks determined by percentages of an overall pooled principal amount.[131] The underwriters and broker-dealers then sold the bonds to the investing public.[132] As the trust received proceeds from the loans, a designated indenture trustee—a separate entity from the trustee—paid interest and principal out to bondholders.[133] Sallie Mae retained loan servicing and administrative functions for the trusts, either directly, through subsidiaries, or third parties. Loan servicing responsibilities included collection of payments, providing customer service functions for borrowers, collection efforts on delinquent

124. *See* Tallerico & Gjaja, *supra* note 119, at 704.

125. *See Impact of the Subprime Mortgage Credit Crisis on Student Loan Cost and Availability*, FINAID, http://www.finaid.org/loans/creditcrisis.phtml (last visited Feb. 2, 2015), *archived at* http://perma.cc/3G44-VZRN.

126. *See id.* (discussing benefits of securitization).

127. *See Navient Student Loan Trusts 2006*, *supra* note 115; *SLM Private Credit Student Loan Trust 2006-A*, NAVIENT, https://www.navient.com/about/investors/debtasset/slmsltrusts/issuedetails/2006-A.aspx (last visited May 27, 2015), *archived at* https://perma.cc/GH38-KSM2; *SLM Private Credit Student Loan Trust 2006-B*, NAVIENT, https://www.navient.com/about/investors/debtasset/slmsltrusts/issuedetails/2006-B.aspx (last visited May 27, 2015), *archived at* https://perma.cc/EJZ8-HWXJ; *SLM Private Credit Student Loan Trust 2006-C*, NAVIENT, https://www.navient.com/about/investors/debtasset/slmsltrusts/issuedetails/2006-C.aspx (last visited May 27, 2015), *archived at* https://perma.cc/5AU4-DCJD.

128. *See* SALLIE MAE, INC., TRUST 2006-A, *supra* note 115, at vii-viii; *Navient Student Loan Trusts 2006*, *supra* note 115.

129. *See Navient Student Loan Trusts 2006*, *supra* note 115.

130. *See supra* note 115.

131. *See* LOONIN, *supra* note 57, at 4.

132. *See id.*

133. *See* SALLIE MAE, INC., TRUST 2006-A, *supra* note 115, at S-5.

loans, and recordkeeping requirements.[134] As trust administrator, Sallie Mae primarily provided accounting and tax reporting services.[135]

The securities were divided into multiple classes that determined how principal and interest would be allocated to bondholders.[136] Each note class was required to obtain certain ratings on the notes from credit rating agencies.[137] For example, class A notes had to obtain the highest ratings available from two of the three major ratings agencies.[138] These notes had priority in receiving principal payments from the underlying loans, while lower classes received principal payments only after higher classes had been paid.[139] Interest was calculated from the LIBOR index, plus or minus an additional spread, with the highest rated tranches holding the lowest spread. Thus, as the likelihood of principal payments being made decreased, the interest rate increased inversely, providing riskier classes with higher interest payments.[140] Additionally, the trusts entered into interest rate swap agreements with major investment banks, referred to as "counterparties," to attempt to hedge some of the risk to noteholders.[141] Under the agreements, the swap counterparties paid the trust quarterly-interest payments based on the LIBOR index, while the trust, in return, made interest payments to the counterparties based on a prime lending determined by the Wall Street Journal.[142]

XI. THE INVESTORS

The private-student-loan business has been extremely profitable for lenders, largely due to the securitization of loans and the accompanying risk that has been passed onto investors. By 2005, Sallie Mae's stock price traded for approximately 1,900% of its 1995 price. During this time, eighty-seven percent of Sallie Mae's lending was under the FFEL program. Private loans, however, represented a product with an ability to generate higher profits than loans made through the FFEL program.[143] These earnings were the result of increased borrowing and investor demand for SLABS, causing the market to peak at $20 billion in 2008.[144] Beginning in 2007, the sharp rise in variable interest rate indices, like the LIBOR, caused rates on private student loans to rise accordingly and increased payments from borrowers. Investors assumed the

134. *See id.* at 69.
135. *See id.* at 72.
136. *See id.* at S-1 to S-2.
137. *See* SALLIE MAE, INC., TRUST 2006-A, *supra* note 115, at S-15.
138. *See id.*
139. *See id.* at S-31.
140. *See id.*
141. *See* SALLIE MAE, INC., TRUST 2006-A, *supra* note 115, at S-45.
142. *See id.* at S-46.
143. *See* McLean, *supra* note 20.
144. *See* CFPB, *supra* note 53, at 17-18.

risk of default on SLABS, an arrangement that caused lenders like Sallie Mae to lend at great volumes and provided little incentive for lenders to scrutinize borrowers' creditworthiness.[145]

The tremendous investor demand for SLABS and the skyrocketing profits of the 1990s and early- to mid-2000s began to wane in 2007, when two major events sent the industry spiraling downward: the subprime-mortgage crisis and the College Cost Reduction and Access Act of 2007. The subprime-mortgage crisis began to impact the credit markets in 2006 to 2007. The crisis initially affected subprime mortgage lending. The impact of the crisis, however, soon reached borrowers with prime loans as interest rates increased, people lost their jobs, and foreclosure and loan defaults reached record levels. Student loan lending appeared to be isolated from the turmoil in the mortgage markets as the government continued guaranteeing federal loans and loan providers generally directed private lending at more creditworthy borrowers than much of the subprime mortgage lending crisis.[146] Despite this apparent isolation, the panic soon spread to the ABS market. Investors, who initially became wary of the high default rates occurring in the mortgaged-backed-securities market, began moving away from other ABS, including SLABS, beginning in 2007.[147]

At the same time that trouble developed in the mortgaged-backed-securities market, the Bush Administration signed the College Cost Reduction and Access Act of 2007 (CCRA) into law.[148] The CCRA greatly expanded the availability of Pell Grants to low-income students, slashed subsidies to industry lenders under the FFEL program, created an Income Based Repayment option and loan forgiveness for borrowers working in public service, and capped loan interest rates at just over three percent.[149] The credit crisis in conjunction with the new law caused Sallie Mae, in a filing with the SEC, to warn shareholders of an expectation that many participants would exit the market as a result of both events.[150] Following the credit crisis and the CCRA, a severe contraction occurred in the SLABS market, and by 2011, the market shrunk to $6 billion from its peak of $20 billion in 2008.[151]

By 2008, investors were trying to exit the SLABS market as defaults on

145. *See id.*

146. *See Impact of the Subprime Mortgage Credit Crisis on Student Loan Cost and Availability*, *supra* note 125. Private student loan underwriting standards required higher FICO scores than subprime mortgage borrowers. Despite this, minimum requirements for FICO scores were lowered to increase private student loan borrowing between 2005 and 2007. *See* CFPB, *supra* note 53, at 23.

147. *See* CFPB, *supra* note 53, at 23.

148. *See* College Cost Reduction and Access Act, Pub. L. No. 110-84, 121 Stat. 784 (2007).

149. *See* Ian Shapira, *Bush Signs Sweeping Student Loan Bill into Law, Adding an Asterisk*, WASH. POST (Sept. 28, 2007), http://www.washingtonpost.com/wp-dyn/content/article/2007/09/27/AR2007092700958.html, *archived at* http://perma.cc/9Z76-PCLB.

150. *See* SLM Corp., Annual Report (Form 10-K) 9 (Feb. 29, 2008), *available at* http://www.sec.gov/Archives/edgar/data/1032033/000095013308000892/w49222e10vk.htm, *archived at* http://perma.cc/Z5ZP-644N.

151. *See* CFPB, *supra* note 53, at 3.

loans reduced profits.[152] Many investors were unable to sell because of widespread liquidity problems.[153] In addition, auction rate securities within the SLABS market faced widespread problems as investment banks discontinued auctions due to declining investor interest, effectively eliminating the primary marketplace for the securities. Following the discontinuation of auctions, investors' only option for liquidating auction-rate securities was to sell through secondary market broker-dealers that purchased the securities at a sharp discount. The failure of the auction rate market was particularly devastating to investors because they had often purchased the securities as an alternative to money-market accounts due to their slightly higher return. Investment banks had frequently marketed auction-rate investments as "cash equivalents" with assurances of certain liquidity.

The problems in the auction-rate-securities marketplace prompted multiple attorneys general investigations, leading to the recovery of settlements on behalf of investors.[154] These payments were limited because investment banks typically only paid investors who held auction-rate securities at the time the settlement was reached; investors that had changed brokerage firms were often left with nothing.[155]

The largest private-loan lenders emerged from the credit crisis relatively unaffected. Sallie Mae ended fiscal years 2008-2010 with net earnings, despite the disappearance of the SLABS market and the liquidity problems facing auction-rate securities.[156] Other lenders, like Wells Fargo, faced less overall exposure to the upheaval in the private-loan market because they are more diversified.[157]

A second era of private student loan lending is emerging as securitization picks up again. In February 2013, Sallie Mae issued $1.1 billion in notes secured by private loans.[158] The amount of the deal represented a significant decrease from the precrisis era; the issuance was tremendously successful, however, and demand for the riskiest bonds vastly exceeded supply. Investor demand was attributed to profit seeking while interest rates remained low.

152. *See id.* at 18.

153. *See* AUSTIN, *supra* note 117, at 5-17.

154. *See* Press Release, Attorney Gen. of Mass., Morgan Stanley & Company Agrees To Repay Massachusetts Municipalities for Auction Rate Securities Investments (Aug. 7, 2008), *available at* http://www.mass.gov/ago/news-and-updates/press-releases/2008/morgan-stanley-agress-to-repay-ma-municipalities.html, *archived at* https://perma.cc/BQ6D-9844; *see also* Beth Healy, *Brokerage Is Charged with Fraud: Oppenheimer & Co. Denies Galvin's Claim It Misled on Securities*, BOS. GLOBE, Nov. 19, 2008, at B5.

155. *See* Gretchen Morgenson, *The Investors Who Can't Come In from the Cold*, N.Y. TIMES (Nov. 28, 2008), http://www.nytimes.com/2008/11/30/business/30gret.html?pagewanted=all&_r=0.

156. *See generally Earnings Information*, SALLIE MAE, https://www.salliemae.com/about/investors/stockholderinfo/earningsinfo/ (last visited Feb. 3, 2015), *archived at* https://perma.cc/HGA8-56WH.

157. *See* Rosengarten & Jhaveri, *supra* note 63.

158. *See* Ruth Simon et al., *Student-Loan Securities Stay Hot: Investors' Hunger for Returns is Driving Demand Even as More Borrowers Fall Behind on Their Payments*, WALL ST. J. (Mar. 3, 2013), *available at* http://www.wsj.com/articles/SB10001424127887323293704578334542910674174.

Despite the renewed interest in SLABS, borrowers continue to face difficulties paying private loans and the Federal Reserve estimates that thirty-one percent of borrowers were at least ninety days behind on payments, a figure representing both Federal- and private-student-loan borrowers.[159]

The risk of default attributable to private lending remains unclear as, despite overall high default levels, lenders have significantly tightened underwriting criteria.[160]

XII. RECENT LITIGATION

Student loan lending has produced litigation concerning both federal and private loans in recent years. Note holders often commence this litigation, but borrowers have brought affirmative claims as well. Private-loan-promissory-note holders often bring actions to recover payments from borrowers in default. To recover, a plaintiff must be able to show that: it is the current holder of a student loan promissory note; the defendant signed the note; and the note is in default. Additionally, a plaintiff must be able to produce the note and document any previous assignments from other parties. Securitization frequently complicates a plaintiff-lender's ability to produce a note because of the multiple assignments that usually occur before a note is assigned to a trust. A plaintiff who cannot produce a note will not be able to recover for a defaulted loan. The multifaceted nature of securitization, and a plaintiff's inability to prove ownership, may provide borrowers with relief. A defendant may also raise contract law defenses such as mistake, fraud, or infancy, as well as a statute-of-limitations defense.[161]

Borrowers may be able to bring affirmative actions against lenders or schools to seek loan relief. Bringing an affirmative action for student loan relief has, however, become more difficult due to several recent judicial decisions. Courts have recently held that plaintiffs who appear to be more sophisticated consumers, notably law students, may not obtain relief for misleading employment statistics. Two courts, in 2012, dismissed suits brought against the Thomas M. Cooley Law School and New York Law School, where the plaintiffs alleged misrepresentation of employment statistics.[162]

The Supreme Court limited borrowers' ability to file class action lawsuits in its 2011 *Concepcion* decision.[163] The Court held that the Federal Arbitration Act preempted state law, which prevented the use of arbitration clauses and

159. *See id.*

160. *See* Rosengarten & Jhaveri, *supra* note 63.

161. *See* DEANNE LOONIN, STUDENT LOAN LAW 229-31 (4th ed. 2012).

162. *See* Gomez-Jimenez v. N.Y. Law Sch., 943 N.Y.S.2d 834, 843-44 (Sup. Ct. 2012) (rejecting claim of misleading post-graduate employment statistics), *aff'd*, 956 N.Y.S.2d 54 (App. Div. 2012).

163. *See generally* AT&T Mobility LLC v. Concepcion, 131 S. Ct. 1740 (2011).

categorized such clauses as unconscionable.[164] The *Concepcion* decision made class actions against schools and lenders far more difficult to bring and encouraged lenders to include arbitration clauses in promissory notes. Arbitration clauses precluding class actions prevent distressed borrowers from bringing less costly class-based claims.

Following *Concepcion*, a federal appeals court held that student loan borrowers seeking class relief were compelled to participate in arbitration with a defendant-lender.[165] The plaintiffs borrowed in excess of $50,000 in private loans to attend Silver State Helicopters, LCC, a flight-training school that went bankrupt. The plaintiffs brought suit against Silver State's preferred lender, Key Bank, and loan servicer, Great Lakes Educational Loan Services. The dissent categorized the promissory notes as unconscionable under California law due to the plaintiff-borrowers' lack of knowledge of the arbitration clauses and the advantage provided to Key Bank by the costly process. The dissent further noted Silver State's misleading marketing materials and Key Bank's knowledge of the school's dire financial status.[166]

XIII. CONCLUSION

Private student loan lending is disproportionately concentrated among nontraditional students who often borrow in large amounts and borrow before exhausting other federal aid. Borrowers are facing increasingly aggressive collection efforts while receiving little in the way of advocacy or relief. The continuing high default rates and the lack of meaningful repayment options raise concerns that lessons from the recent past have not been learned, as investor demand for SLABS has once again begun to grow. Further regulatory reforms would protect investors from market instability and illiquidity caused by rising borrower defaults.

Bankruptcy relief should be restored to protect distressed borrowers from the hazards of excessive private-student-loan debt. Historical trends indicate that allowing for discharge of student-loan debt does not encourage borrowers to default on payments. Also, as private student loans do not permit protections such as income-based repayment, it is even more important that borrowers receive bankruptcy relief. Significantly, members of both the House and Senate recently introduced bills allowing for the discharge of private student loans in bankruptcy.[167] The enactment of these bills would provide much

164. *See id.* at 1753 (holding Federal Arbitration Act preempted state law preventing arbitration clauses).

165. *See* Kilgore v. KeyBank, Nat'l Ass'n, 718 F.3d 1052, 1054 (9th Cir. 2013).

166. *See id.* at 1062 (Pregerson, J., dissenting) (noting misleading promises of Silver State).

167. *See* Private Student Loan Bankruptcy Fairness Act of 2013, H.R. 532, 113th Cong. § 2 (2013) (proposing amending provision allowing discharge of debts for educational loans); Fairness for Struggling Students Act of 2013, S. 114, 113th Cong. § 2 (2013) (suggesting amending exceptions to discharge in bankruptcy).

needed relief to struggling private loan borrowers.

Borrowers who fall behind on private-student-loan payments, or enter default, should be provided with options for refinancing. This relief could be provided through income-based repayment plans similar to those available for federal-student-loan borrowers. It is significant that private-student-loan lenders and investors currently benefit from bankruptcy protection, but lenders are not required to provide debt refinancing. Thus, the law benefits lenders more than it benefits the federal government and American taxpayers. Notions of fairness make provision of refinancing and income-based repayment both reasonable and prudent, so long as private student loans remain nondischargeable in bankruptcy.

Borrowers should be encouraged to exhaust cheaper federal student loan options before turning to private student loans. Financial literacy and educational services should address responsible student loan borrowing, and financial aid offices should direct students to exhaust all federal aid. In addition, the financial aid application process should be simplified to prevent borrower confusion regarding loan types and terms. More rigorous pre-application counseling and disclosure of loan products and terms could accomplish this initiative. The Credit Card Accountability, Responsibility and Disclosure Act of 2009 (CARD Act) requires credit card lenders to provide clear notice of repayment duration and terms and to avoid using complex financial terminology.[168] Disclosure requirements in plain language on private-student-loan applications and product advertisements would prevent borrowers from mistakenly believing they were borrowing federal funds. These disclaimers could also inform borrowers of the expenses and unfavorable terms associated with private loans.

The federal-student-loan program must continue to offer an attractive alternative to private student loans. The Bipartisan Student Loan Certainty Act (BSLCA) recently lowered interest rates on federal student loans for students entering school in 2013. BSLCA shifts the cost, however, to future students by potentially increasing interest rates to as high as 10.5% on PLUS loans. Federal student aid should remain an affordable alternative to costly private loans tied to a variable interest rate.

As a last resort, borrowers should be able to pursue efficient judicial relief when misrepresentation or unconscionable loan terms arise. Recent case law has curtailed borrowers' ability to bring cheaper class action lawsuits and has encouraged lenders to include arbitration clauses in loan documents. These agreements, formerly held unconscionable under certain state laws, are now

168. *See* Credit Card Accountability Responsibility and Disclosure Act of 2009, Pub. L. No. 111-24, 123 Stat. 1734 (codified in scattered sections of 15 U.S.C.); *CARD Act Factsheet*, CONSUMER FIN. PROT. BUREAU, http://www.consumerfinance.gov/credit-cards/credit-card-act/feb2011-factsheet/, *archived at* http://perma.cc/W8C9-BPBS.

protected by federal law and require borrowers to bring claims independently or pursue costly arbitration procedures.