

November 12, 2008

The Honorable Rick Perry
Governor
P.O. Box 12428
Austin, Texas 78711

RE:

- The Federal Family Education Loan Program (“FFELP”) in Texas
- Update of Congressional Activity Related to the Student Loan Liquidity Issue

Dear Governor Perry:

As you know, the Texas Guaranteed Student Loan Corporation (“TG”) is the statutorily-designated guarantor and administrator of the FFELP for the State of Texas. TG is a state-created, non-profit corporation, which was established by an Act of the Texas Legislature. It operates under a Board of Directors which you appoint and is subject to certain state government-related laws, such as the Texas Public Information Act, Open Meetings Act, and the Sunset Act. Its primary functions, according to TG’s enabling legislation, are to:

- Administer a guaranteed student loan program to assist qualified Texas students in receiving a postsecondary education in this state and elsewhere in the nation;
- Provide necessary and desirable services related to the FFELP loan program; and
- Report to the State’s policymakers on the level of demand for student financial aid for postsecondary education in this state.

In keeping with these responsibilities, and consonant with the status of TG as the only entity with designated responsibility for, and a defined mandate with respect to, the administration of the FFELP within the State, TG seeks to provide you with information on the current and emerging state of FFELP access in the State of Texas as a result of the financial liquidity problem impacting segments of the FFELP lending community.

The good news is that, to TG’s knowledge, not a single student or parent seeking a student or parent loan through the FFELP in Texas was unable to find a lender willing to originate a loan for the current semester of the 2008-2009 academic

year. TG has not received a single request for a FFELP loan through its lender-of-last-resort program for this academic year.

TG is working with our FFELP partners and policymakers to continue this positive situation, but concerns still exist.

FFELP in Texas

The FFELP is the largest source of student financial aid in the nation. It provides over 55% of the direct student financial aid awarded annually nationally, and 66% of the student aid awarded in Texas.

Nationally, the FFELP has provided \$460 billion in federally-insured student loans to approximately 135 million borrowers. TG has guaranteed approximately \$50 billion to over 3 million borrowers, and is processing over \$6 billion in loans to half a million borrowers annually. \$3.2 billion of this amount is to Texas students and parents.

These amounts are primarily provided by private lenders and non-profit lenders and secondary markets, four of which are organized under Chapter 53B of the Texas Education Code.

A Federal Direct Loan Program (“FDLP”), established 15 years ago, provides only about 23 percent of federal loan volume nationally, and six percent in Texas. The FFELP originated about \$53 billion in student and parent loans in 2006 and the FDLP originated about \$14 billion. These figures do not include \$57 billion in consolidation loans in the FFELP and \$19 billion in FDLP consolidation loans.

In Texas, the FFELP provides 94% of the federal student loans currently awarded to Texas postsecondary education students annually, and has been the student loan program of choice for most Texas colleges and universities.

Therefore, a strong FFELP plays an important role in ensuring financial access to postsecondary education for Texas students and families, and the consequent implications of success to the State’s “Closing the Gaps” initiative, is evident.

Student Loan Liquidity Issue

Currently, the FFELP is experiencing a great challenge. 127 FFELP lenders nationwide have completely terminated FFELP lending programs or suspended FFELP lending. Last year, these lenders originated \$8.7 billion in FFELP loans to more than 1 million borrowers (17.6% of the national FFELP loan volume). In Texas, this represents approximately \$260 million in loan volume and almost 10% of the statewide volume. This limitation results from a confluence of events, which include:

- The statutory reduction of compensation, interest rate, allowances, and favorable economic treatment for FFELP lenders, which makes participation in the FFELP much less attractive for lenders;
- The general effects of the overall liquidity crisis experienced in capital markets, but with special reference to student-loan related offerings. Student loan collateral, created after the various lender cuts went into effect, is commercially undesirable in this market because it offers inadequate yield without significant, costly credit enhancements. This means that lenders have been unable to access equity in student loans through securitizations, to lend further within the program. Loans originated after October 1, 2007 have such low commercial viability in securitizations that they have not be considered for inclusion in bond packages and are considered “locked equity”;
- Secondary market facilities are unable to purchase loans from lenders to assist in the process since they, too, are hampered by the same factors, when they seek liquidity from purchased loans; and
- Lenders have competing lending markets for available funds which are more financially attractive than student loans, particularly in these challenging times in which such institutions are highly interested in capital preservation, which they are currently not able to securitize.

The liquidity issue within the student loan programs is allied closely with and similar to the sub-prime mortgage issues. The first indicators of negative effects on the student loan industry were evidenced by pressure upon and exit of lenders from the private, non-federally insured student loan market, which is different from the FFELP lending, especially in its risk assumptions. Concern regarding student loan collateral value was heightened by the collapse of the auction-rate securities (“ARS”) market, which then especially punished the portfolio holdings of illiquid ARS collateralized by student loans with impaired valuation. A concern which commenced as an isolated issue among non-depository lenders and secondary market lenders had by summer of 2008 fully spread into the federally-insured student loan market, resulting in some federally-insured, traditional depository banks announcing suspension or termination of their participation in both the private, non-federally insured student loan market, as well as the federally-insured market, which continues through present times. Currently, the overall economy and the student loan industry are pointedly suffering from the effect of the broader collapse of the country’s financial and credit markets and consequent recession. Many remaining lender-participants are now limiting their FFELP participation to issuance of student loans to benefit students at traditional 4-year universities, graduate and professional institutions, institutions with low cohort rates, and institutions which lenders believe will produce graduates which have the most substantial likelihood of repayment. For the near-term, the FFELP will be challenged with lender availability and overall access concerns at rank-and-file schools.

The FDLP could serve as an option for educational institutions if lenders continue to exit the FFELP. In addition to the FDLP, a second option exists with the FFELP for institutions that may lose their FFELP lenders. Those institutions may use a program provided through guaranty agencies, such as TG, called the Lender-of-Last-Resort program, which is authorized and mandated under Section 428(j) of the Higher Education Act. The LLR Program provides FFELP loans to students who are unable to find conventional FFELP loans in the open marketplace. TG has been in contact with David Young of your staff, the FFELP lending community, and the Texas Higher Education Coordinating Board, working diligently to ensure that Texas has a viable Lender-of-Last-Resort program in the event the current situation necessitates the broad-scale operation of the program in the near future. Additionally, as indicated by the attached letters, Texas state policymakers have also intervened and had a positive impact.

However, the full and long-term effect of all of the actions described related to ensuring universal access to federal student loans will not be known for several months.

Congressional and Federal Activity

Action taken by the Federal Reserve on May 2nd targeting the global credit crisis, in concert with European central banks, included an injection of cash into the student loan market through a special lending operation. With that, the Federal Reserve allows investment firms and banks to use bonds backed by federally-guaranteed student loans as collateral for the loans of safe Treasury securities that the central bank is making available.

Additionally, the U.S. Department of Education and the FFELP lending community have worked to implement the Department's legislatively-mandated temporary role as the FFELP "secondary market of last resort" (see "ECASLA", below) which provides participating lenders with a limited opportunity to obtain liquidity from the Department sufficient to cover their costs and originate new FFELP loans. These policy changes will provide immediate, albeit temporary, liquidity into the FFELP lending arena.

Ensuring Continued Access to Student Loans Act ("ECASLA")

In March and April, Senator Kennedy and Representatives Hinojosa and Miller filed legislation (S. 2815-Strengthening Student Aid For All Act/H.R. 5715-Ensuring Continued Access to Student Loans Act) in the Congress to address the liquidity issue beginning to affect the FFELP.

On April 31st and May 1st, the House and Senate approved a compromise version of ECASLA which included parts of both the Kennedy/Miller legislation. The President signed the bill into law on May 9, 2008, and later signed a subsequent bill, H.R. 6889, extending ECASLA's provisions for an additional year, through

July 2010. ECASLA, Pub. L. 110-227, and its extension, Pub. L. 110-350, contain the following key provisions:

- *Loan limits* – The new law clarifies that the increased loan limits apply to loans first disbursed on or after July 1, 2008.

The new law raises the annual federal loan limit for unsubsidized Stafford loans for dependent undergraduate students, or students whose parents cannot obtain federal parent loans because of poor credit, by \$2,000. It also increases the aggregate amount an undergraduate dependent student may borrow under the unsubsidized Stafford loan program to \$31,000. Further, the new law increases the annual federal loan limit for unsubsidized Stafford loans for independent undergraduate first- and second-year students, or students whose parents cannot obtain federal parent loans because of poor credit, by \$2,000, from \$4,000 to \$6,000, and it increases the maximum annual amount for undergraduate independent students who have completed two years of study by \$2000, from \$5000 to \$7000. The aggregate amount of unsubsidized Stafford loans for an undergraduate independent student is increased to \$57,500.

- *PLUS loans* – The new law provides that extenuating circumstances exist, and therefore an applicant does not lose PLUS loan eligibility, if, during the period beginning January 1, 2007 and ending December 31, 2009, he or she is or was less than 180 days delinquent on mortgage loan or medical bill payments and was not more than 89 days delinquent on other debt.

The new law also gives a parent borrower more time to begin repaying off federal PLUS loans. Currently, parent borrowers must begin repayment 60 days after disbursement of the loan; parents will be able to defer repayment until six months after the student beneficiary fails to carry at least one-half the normal full-time workload.

- *Lender-of-Last-Resort* – The new law provides that no Lender-of-Last-Resort loans shall be made with interest rates, origination or default fees, or other terms and conditions that are more favorable to the borrower than the maximum applicable under the HEA for the type of loan involved. It also provides that (i) the authority of the Secretary to designate schools as eligible for lender-of-last-resort loans, and any such designation of a school, expires on June 29, 2009; (ii) each guaranty agency or lender serving as a lender of last resort is subject to the guaranty agency and lender prohibited inducement provisions contained in the HEA; and (iii) guaranty agencies and lenders serving as lenders of last resort shall not advertise, market or otherwise promote Lender-of-Last-Resort loans (though guaranty agencies must

ensure that schools have information about the availability of the lender-of-last-resort program in the State). Finally, the Secretary of Education is directed to disseminate information on the Lender-of-Last-Resort program, to make publicly available new or revised plans or agreements made by guaranty agencies, and to provide reports on Lender-of-Last-Resort activities.

The law requires the Secretary of Education, upon request of a school and in accordance with standards developed by the Secretary, to designate the school as eligible for the Lender-of-Last-Resort program on an institution-wide basis, rather than on a student-by-student basis, and clarifies that it will cover not only subsidized Stafford loans, but also unsubsidized Stafford loans and PLUS loans. It specifically excludes consolidation loans. ECASLA also clarifies that existing law gives the Secretary the authority to advance federal funds to guaranty agencies in the event that they do not have sufficient capital to originate new loans, and appropriates such sums as may be necessary for carrying out the requirements of the Lender-of-Last-Resort program. Further, ECASLA and its extension:

- Provide the Secretary with authority to purchase, and to enter into forward purchase commitments to purchase, before July 1, 2009, FFELP loans (other than consolidation loans) made on or after October 1, 2003.
- Provide that, rather than issuing emergency regulations pertaining to such purchases, the Secretary, together with the Secretary of the Treasury and the Director of Office of Management & Budget (“OMB”), shall publish a Federal Register notice that establishes the terms of such purchases, an outline of the factors to be used in evaluating the price of such purchases, and a description of how the price meets the requirement that the purchase does not result in a net cost to the federal Government.
- Establish this temporary authority in the event that the Secretary determines there is inadequate availability of loan capital. The Secretary, in consultation with Treasury and OMB, must determine that the terms of the purchase are in the best interest of the United States, and provide that any purchase cannot result in a net cost to the Federal Government.
- Require the Secretary to assure that the funds paid by the Secretary shall be used to ensure continued participation by the lender in the FFELP and to originate new FFELP loans to students. The Secretary is authorized to contract with the lender for continued servicing, provided that the cost of such servicing cannot exceed the cost the Federal Government would otherwise incur and that continued servicing is in the best interest of borrowers.

The new law also makes a number of changes to the ACG and SMART grant programs.

The law includes S. 2815's "Sense of Congress Statement" that the Federal financial institutions, such as the Federal Financing Bank and the Federal Reserve, and the federally-chartered entities such as the Federal Home Loan Banks, use their available authorities, if needed, to assist in ensuring that students and families have access to student loans for academic year 2008-2009, and the subsequent academic year, if needed.

Unfortunately, there does not appear to be liquidity relief for secondary market providers within the terms of ECASLA or its extension, although the Secretary may be able to exercise authority to provide such relief. However, as the Department of Education has proceeded to implement this legislation, coupled with the recent passage of the Emergency Economic Stabilization Act, it appears that capital funding for FFELP loans will be available through the fall semester of 2010.

In order to provide a more permanent solution beyond 2010, TG is encouraging the Texas Congressional Delegation and others to support the passage of two additional bills as soon as the 111th Congress convenes next year:

- Congressman Paul Kanjorski and Senator John Kerry have filed legislation (H.R. 5723/S. 2847 – The Emergency Student Loan Market Liquidity Act), proposing to allow the 12 Federal Home Loan Banks to assist student loan lenders by enabling the Banks to:
 - temporarily (for 2 years) invest in student loan-related securities with their surplus funds;
 - accept student loans and student loan-related securities as collateral; and,
 - provide secured advances of funds to its members (savings & loan associations, cooperative banks, & mortgage lenders) to originate student loans or finance student loan-related securities.

- Congressman Kanjorski has also filed H.R. 5914 – The Student Loan Access Act – that provides the Treasury Department's Federal Financing Bank with the explicit authority to:
 - purchase loans guaranteed under Part B of the Higher Education Act;
 - make advances to eligible FFELP lenders for the purposes of originating or purchasing Federal loans; and,
 - invest in securities collateralized with student loans originated under part B of the Higher Education Act.

These provisions would exist only for the 2008-2009 academic year, but could be extended year to year. If H.R. 5914 were to be enacted, the provisions would permit a swift and effective solution to the current and potential future FFELP liquidity issues

In order to effectuate an integrated solution to the current financial concerns, a number of factors need to be congruently addressed in federal legislation. TG remains hopeful that enacted legislation will produce a solution that results in little or no disruption to those seeking federal student loans in 2009 and thereafter.

TG anticipates that among the major issues facing the new Administration and new Congress next year will be proposals to restructure the federal student financial aid and student loan programs. This issue may be considered in concert with the FY2009 budgetary process or initiated for consideration as separate legislation. In either event, TG believes that the consideration will be a topic on the agenda, and these issues are likely to be a part of these proposals. The FFELP is an important part of Texas' *Closing the Gaps* initiative and providing financial access to postsecondary education in Texas. I will continue to keep you apprised of situational and federal legislative developments of concern, and will request that you contact our Delegation to support and assure a strong, viable FFELP in Texas through appropriate federal legislation.

Please contact George Torres, Assistant Vice President – Legislative Affairs, at 512-219-4503 or george.torres@tgslc.org, for any assistance with information on the issues addressed in this letter.

Sincerely,

Sue McMillin
President and CEO

CC: The Honorable Ruben Hinojosa
The Honorable Judith Zaffirini
The Honorable Dan Branch
Dr. Raymund Paredes, Commissioner of Higher Education