Student Aid Policy Analysis

Impact of the Bankruptcy Exception for Private Student Loans on Private Student Loan Availability

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The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA) amended the language at 11 U.S.C. 523(a)(8) to include an exception to discharge for "qualified education loans" (IRC §221(d)(1)) effective October 17, 2005. The definition of qualified education loan includes most private student loans. Before this change, only private student loans funded in whole or in part by nonprofit institutions were exempt from discharge.

This report analyzes whether the change in the bankruptcy code resulted in greater availability of private student loans. It examines the FICO score distributions in the prospectuses for private student loan securitizations before and after the effective date of the BAPCPA change. If education lenders had relaxed their eligibility criteria, one would expect to see an increase in the percentage of private student loans made to borrowers with lower credit scores. This report finds only a slight overall increase in the availability of private student loans to borrowers with FICO scores less than or equal to 650.

This report does not analyze whether BAPCPA lead to any changes in the cost of private student loans, such as changes in the guarantee fees.

FICO Score Distributions in Private Student Loan Securitizations

The prospectuses for two groups of securitizations were analyzed based on SEC filings available through EDGAR:[1]

- SLM Private Credit Student Loan Trusts 2002-A, 2003-A, 2003-B, 2003-C, 2004-A, 2004-B, 2005-A, 2005-B, 2006-A, 2006-B, 2006-C and 2007-A issued by Sallie Mae.
- National Collegiate Student Loan Trusts 2004-1, 2004-2, 2005-1, 2005-2, 2005-3, 2006-1, 2006-2, 2006-3, 2006-4, 2007-1 and 2007-2 issued by First Marblehead.

FICO scores were clustered into five groups:

- Less than or equal to 650
- Greater than 650 and less than or equal to 710
- Greater than 710 and less than or equal to 750
- Greater than 750
- FICO score not available

Where multiple FICO scores were available, this report uses the ones closest to the application date.

[1] www.sec.gov/edgar.shtml

The FICO score distribution statistics are based on loan volume, not the number of borrowers. The Sallie Mae prospectuses do not provide per-borrower statistics. Although the First Marblehead prospectuses include data for both, this report focuses on the loan volume statistics to ensure comparability with the Sallie Mae data. The First Marblehead per-borrower FICO score distribution data is similar to the FICO score distribution data based on loan volume.

This report analyzes the percentage distribution of FICO scores and not dollar totals, as any increase in the loan volume could be attributable to overall growth in the demand for private student loans and not greater availability of loans to borrowers in the lowest group of FICO scores. In addition, the dollar figures are uneven from securitization to securitization, making a relative loan volume comparison more informative than an absolute comparison.

The FICO score distributions in this report were normalized to exclude loan volume statistics from loans without FICO scores. It is unclear how the loans without FICO scores would have affected the distribution if FICO scores had been available for these loans. However, Sallie Mae's securitizations show a significant drop in the percentage of loans without FICO scores starting with the 2004-B securitization. 27.4% of loans in 2002-A through 2004-A had no FICO scores, compared with 5.2% of loans in 2004-B through 2005-B. The percentage of loans with FICO scores ≤ 650 increased by 0.3%, compared with a 8.4% increase in loans with FICO scores of 651-710, 6.7% increase in loans with FICO scores of 711-750 and 6.8% increase in loans with FICO scores > 750. So it is reasonable to assume that most of the loans without FICO scores in 2004-A and before would not have had FICO scores less than or equal to 650. It is also worth noting that the percentage of loans without FICO scores decreased from 5.2% in 2004-B through 2005-B to 4.3% in 2006-A through 2007-A. (The percentage of First Marblehead loans without FICO scores increased from 3.0% in 2004-1 through 2005-3 to 4.2% in 2006-1 through 2007-2.)

The 2006 and 2007 securitizations include loans originated before BAPCPA. For example, of the Sallie Mae securitizations, 2006-A had 100% disbursed before January 1, 2006, 2006-B had 84.7%, 2006-C had 64.1% and 2007-A had 18.4%. (The First Marblehead prospectuses do not include information about the distribution of loan volume according to disbursement date.) The inclusion of prior year loans in the securitizations would tend to dilute the impact of greater loan availability. Nevertheless, one would expect to see a measurable impact. Comparisons of the post-BAPCPA averages with the 2007 securitizations yield consistent results.

Loans with and without Co-borrowers

FICO score distributions were analyzed for all loans, for all loans with co-borrowers, and for all loans without co-borrowers.

When students are unable to borrow based on their own credit scores, they often try borrowing with a cosigner. A decrease in the availability of loans to borrowers with low credit scores might therefore result in a shifting of loan volume from loans without co-borrowers to loans with co-borrowers. Both the Sallie Mae and First Marblehead student loan pools demonstrated an increase in the proportion of loans with co-borrowers. The percentage of Sallie Mae loans with co-borrowers increased from 47.9% in 2002-A through 2005-B to 54.6% from 2006-A through

2007-A. The percentage of First Marblehead loans with co-borrowers increased from 80.3% in 2004-1 through 2005-3 to 81.8% from 2006-1 to 2007-2.

However, education lenders have an incentive to encourage loans with cosigners, because such loans are less likely to default. Students who could qualify on their own also have an incentive to borrow with a cosigner, as the interest rates and fees tend to be lower on such loans. So it is unclear whether the increase in the percentage of loans with co-borrowers has any real significance with regard to loan availability.

The percentage of loans with co-borrowers is likely to increase in the future. Fair Isaacs has announced that authorized users will no longer inherit the credit history of the primary account holder starting in Fall 2007 and Spring 2008.[2] While this change is intended to combat a form of mortgage fraud known as piggybacking, it will also reduce the number of students who can satisfy credit underwriting criteria on their own. These students will need to apply with a co-borrower in order to qualify for a private student loan.

Distribution of FICO Scores Before and After BAPCPA

The following table illustrates the change in the normalized distribution of Sallie Mae loans before and after BAPCPA for all borrowers (with and without co-borrowers). The 2007-A statistics are similar to the After BAPCPA statistics, with 7.7% of borrowers having FICO scores less than or equal to 650 and 38.9% with FICO scores between 651 and 710.

Sallie Mae PSL Securitizations (By Volume)			
FICO Scores	**Before BAPCPA**	**After BAPCPA**	**Difference**
≤ 650	7.5%	7.7%	0.2%
651-710	36.9%	39.4%	2.5%
711-750	25.9%	23.3%	-2.6%
> 750	29.8%	29.6%	-0.2%
Loan Volume	$8.0 billion	$6.8 billion	

The following table illustrates the change in the normalized distribution of First Marblehead loans before and after BAPCPA for all borrowers (with and without co-borrowers). The 2007-2 statistics are similar to the After BAPCPA statistics, with 10.2% of borrowers having FICO scores less than or equal to 650 and 40.6% with FICO scores between 651 and 710.

First Marblehead PSL Securitizations (By Volume)			
FICO Scores	**Before BAPCPA**	**After BAPCPA**	**Difference**
≤ 650	6.8%	9.9%	3.0%
651-710	38.4%	40.6%	2.1%
711-750	25.9%	23.6%	-2.3%
> 750	28.9%	26.0%	-2.9%
Loan Volume	$3.1 billion	$3.9 billion	

[2] www.fairisaac.com/NR/exeres/FAC104CE-DF7F-4610-8A36-85F39C4ED9AB,frameless.htm

The following table illustrates similar results for First Marblehead using per-borrower data instead of loan volume data.

First Marblehead PSL Securitizations (Per Borrower)			
FICO Scores	Before BAPCPA	After BAPCPA	Difference
≤ 650	6.6%	9.2%	2.5%
651-710	38.3%	39.9%	1.6%
711-750	26.0%	23.9%	-2.1%
> 750	29.1%	27.0%	-2.0%

The following table combines the Sallie Mae and First Marblehead statistics, weighted by loan volume.

Combined Sallie Mae and First Marblehead Statistics			
FICO Scores	Before BAPCPA	After BAPCPA	Difference
≤ 650	7.3%	8.5%	1.2%
651-710	37.3%	39.8%	2.5%
711-750	25.9%	23.4%	-2.5%
> 750	29.5%	28.3%	-1.2%
Loan Volume	$11.1 billion	$10.7 billion	

These results are consistent with a slight increase in availability of private student loans among First Marblehead borrowers and a negligible increase in the availability of private student loans among Sallie Mae borrowers.

The following table shows combined statistics for just the loans without co-borrowers.

Overall PSL Securitizations (By Volume, No Co-borrowers)			
FICO Scores	Before BAPCPA	After BAPCPA	Difference
≤ 650	11.0%	9.3%	-1.7%
651-710	49.7%	54.9%	5.2%
711-750	24.1%	24.5%	0.4%
> 750	15.2%	11.3%	-3.9%
Loan Volume	$4.5 billion	$3.8 billion	

These results are consistent with a slight decrease in availability of private student loans to students without co-borrowers who have FICO scores less than or equal to 650 and a slight increase in availability to students without co-borrowers who have FICO scores between 651 and 710. It is unclear to what extent the students with FICO scores less than or equal to 650 may have shifted into the pool of borrowers with co-borrowers.

Average Weighted FICO Scores Before and After BAPCPA

Another measure of the availability of private student loans is the average weighted FICO score of the student loan pool. The average weighted Sallie Mae FICO score remained unchanged at 718 before and after BAPCPA. The 2007-A pool also had an average weighted FICO score of

718. The average weighted FICO score in the First Marblehead student loan pool decreased from 719 to 715, which would be consistent with a slight expansion in loan availability. The 2007-1 and 2007-2 pools had average weighted FICO scores of 715 and 714, respectively.

Conclusions

This report demonstrates only a slight increase in the availability of private student loans to borrowers with low credit scores after BAPCPA made such loans non-dischargeable. The amount of the increase varies by lender, with Sallie Mae showing a negligible increase in availability and First Marblehead showing a somewhat greater increase in availability.

This report analyzes the distribution of FICO scores before and after BAPCPA. It does not evaluate whether education lenders implemented any changes in their credit underwriting criteria. The prospectuses do not note any significant changes in the credit underwriting criteria, especially in regard to restrictions concerning prior borrower bankruptcy. Inspection of more detailed FICO score data suggests an effective FICO score cutoff of 630 to 640 for Sallie Mae borrowers and 620 to 650 for First Marblehead borrowers and that these thresholds remained essentially unchanged after BAPCPA. The changes in FICO score distributions may have more to do with changes in the source population of the borrowers than in any policy changes by the education lenders.

If Congress were to roll back the BAPCPA exception to discharge for private student loans, as has been proposed by Senator Richard Durbin in S.1561, it is unlikely to result in a significant decrease in private student loan availability to prospective borrowers with low credit scores. But it is also unlikely to provide much relief to borrowers, as many private student loans were non-dischargeable even before BAPCPA because of the involvement of a nonprofit entity in making the loans (e.g., First Marblehead loans are guaranteed by TERI). Borrowers might obtain more relief from the pre-1998 language which allowed for the discharge of education loans after seven years in repayment. Senator Clinton's Student Borrower Bill of Rights Act of 2007 (S.511) includes a provision which would restore this language.

[Update (8/15/07): Sen. Durbin's bill, S.1561, not only rolls back BAPCPA, but also strikes the prior language which extends an exception to discharge to loans "made under any program funded in whole or in part by a … nonprofit institution". It is unclear whether First Marblehead loans were actually excepted from discharge because of the TERI guarantee, since the language is limited to loans funded by a nonprofit institution and specifically does not include language protecting loans insured or guaranteed by a nonprofit institution like it does in the previous clause "an educational benefit overpayment or loan made, insured, or guaranteed by a governmental unit". In any event, Sen. Durbin's bill would clearly eliminate any exception to discharge for all private student loans, even those guaranteed by a nonprofit institution.]