

Discussion of
“Private Student Loans and
BAPCPA”
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Summary



- Paper explores impact of 2005 bankruptcy law change (BAPCPA) on private student loan access
- Uses dataset of private student loan originations before and after law change
- Use three different approaches:
 - ▣ OLS
 - ▣ Oaxaca-Blinder
 - ▣ Matching methods
- Find dramatic increase in volume of loans and small increase in costs between 2005Q1 and 2006Q1

Historical Context



- Authors provide great detail on legal background of the student loan exception to bankruptcy discharge
 - Before 1976: Student loans treated like unsecured debt
 - 1976: Federal loans are non-dischargeable for five years
 - Undue hardship exception
 - 1979: Broaden to nonprofit or government units
 - 1990: 5 years to 7 years
 - 1998: Nondischargeable regardless of length outstanding
 - 2005: Protects private lenders as well
- General trend toward more restrictive treatment of student loans in bankruptcy, despite limited evidence that recent graduates are “gaming the system”

What's The Basis for Exclusion?



- Concerns related to moral hazard or “fraud by design”
- Nondischargeability reduces risk to lenders, which should expand credit supply
 - ▣ More credit, cheaper credit
 - ▣ Willing to lend to riskier borrowers

What Response Should We Expect?

- Authors focus on three predictions
 - ▣ 1) Overall loan volumes should increase
 - ▣ 2) Lenders will lend to riskier borrowers
 - ▣ 3) Lender margins will remain the same
 - If credit rationing is still present, then the supply of loans will increase without any commensurate decrease in the interest rate charged
- Based on Stiglitz-Weiss (S-W) model of credit rationing

Are Student Loans in a S-W World?

- Stiglitz-Weiss: Single interest rate, no risk-based pricing
 - ▣ Student loans have dispersion in rates
 - ▣ Student loans are risk-priced based on credit scoring and other sophisticated underwriting models
- Conditional on observables, can we observe rationing?
 - ▣ Nearly impossible to convincingly test
- Is there a moral hazard problem in student lending?
 - ▣ That is, do higher rates lead to riskier investments?
- Is there an adverse selection problem in student lending?
 - ▣ That is, does a higher rate attract riskier borrowers?

Empirical Approach



- Authors use data from 9 largest private student lenders (PSLs)
- Data from 2005Q1 to 2011Q4
- Focus on originations for undergraduates at 4-year institutions
- Compare 2005Q1 and 2006Q1
 - ▣ Before and After Law Change (passed 2005Q4)
 - ▣ Econometric specification is inclusion of “post” dummy

Pre-Post Design

- A number of obvious concerns:
 - ▣ First, other things may be changing over this period
 - Undergraduate enrollment
 - Student need (determined by income and tuition & fees)
 - Lenders' cost of capital (securitization markets)
 - Etc.
 - ▣ Design thus conflates any other changes with the change in the law

- This is why the difference-in-differences specification is so popular
 - ▣ Can we observe the “pre-post” effect in a control group?
 - **Federal student loans**
 - Not treated by this law change – already nondischargeable

Diff-in-Diff Suggestion



- 2005 law had no impact on Federal student loans
- We should not see any impact on Federal student loans if students in fact borrow up to their federal limits, then go to the private market
 - If they don't do this, we might see spillover effects on federal borrowing
- Would be nice to show that the patterns observed are in fact a reaction to the law change rather than “everything else”

3 More Issues with Pre-Post Design

- Only one period before, one period after
- 1) May be trends in this market that would have happened in the absence of the law change
 - ▣ e.g. Changes to parents co-signing private student loans
 - Early 2000s: Relatively rare
 - By 2011: 90% require co-signer
- 2) Loans originated in Q1 might be weird
 - ▣ Most loans are originated in Q3 when school starts
- 3) By 2005Q1, lenders may have anticipated the law change and already modified lending standards
 - ▣ If anything, this would attenuate the likelihood of observing an effect, but changes interpretation

What do they find?

- Volume rises dramatically
 - ▣ Number of loans rises by 300% in one year!?!
 - ▣ Suggests that other factors are at play
 - ▣ Unlikely that law change had big enough impact on lenders' profits to triple their willingness to lend
 - Could estimate a model of costs that would reconcile this finding
 - Distinguish between formal and “informal” bankruptcy as in Dawsey and Ausubel (2002)
- Average FICO scores of borrowers fall slightly
 - ▣ Could be expanded access, or changing composition of borrowers and need
- Interest rates rise 3.5 basis points
 - ▣ Some of this attributable to change in composition of borrowers to being higher risk

Conclusions



- Results here suggest that nondischargeability dramatically increased availability of private student loans
- Borrowers with lower FICO scores received PSLs post-BAPCPA
- Generally, lack a control group to distinguish between BAPCPA effects and other trends in the PSL market
- Not clear that Stiglitz-Weiss is the right framework for making predictions about how PSL market would respond
 - ▣ Contrast predictions with perfect competition

Other comments for authors

- Table 2 is unnecessary, identical to “differences” row in Table 3
 - ▣ Unless sample is changing
- Pg. 16: Not clear why fraud by design or sufficient defaults to break the student loan market are not concerns in PSL market. Please explain.
- Pg. 17: Not clear how Pottow’s theories are unique to student loans. Don’t borrowers always internalize the cost by paying interest?
- P. 21: Can test whether underwriting appears to be based on highest credit score of borrower / co-borrower
- Do we think credit access affected enrollment? In the absence of PSLs, what were constrained students doing?