

**TESTIMONY SUBMITTED TO THE BANKS AND HIGHER
EDUCATION AND EMPLOYMENT ADVANCEMENT COMMITTEE**
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Department of Banking*

The Effect of the Subprime Mortgage Crisis on the Availability of Funds for Student Loans

Good Afternoon Chairman Duff, Chairman Barry, Chairman Hartley, and Chairman Willis, members of the Banking and Higher Education committees, my name is Howard F. Pitkin and I am the Commissioner of the Connecticut Department of Banking.

I am here to comment on the effect the Subprime Mortgage Crisis is having on the cost and availability of funds for student loans. In general, funds are usually raised for student loans through auction rate securities. Auction rate securities (ARS) are long-term bonds with 30-40 year maturities that are treated by holders as cash equivalents because of auction market that makes bonds liquid every 28 to 30 days.

Due to the subprime crisis, market liquidity for ARS has virtually disappeared. Also, without the ability to offload these securities in a short-time frame, investors have been hesitant to provide additional capital. Thus, a shortage in dollars available for lending results.

The financial aid industry has commented on the situation recently. An article on FinAid, a financial aid information web site, stated that the student loan credit crunch will mainly affect subprime borrowers, who disproportionately attend community colleges and for-profit colleges. The article continued with the conclusion that a low percentage of students will not be able to obtain PLUS and private student loans, and most borrowers will see the cost of their private student loans increase and federal loan discounts at least cut in half (possibly eliminated). Some students will have to spend more time searching for a lender, especially if they want to consolidate their federal student loans. Non-bank lenders will be affected to a much greater extent than the banks, who are able to rely on customer deposits as a source of funds.

Finally, I would like to point out that as we saw with Fannie Mae and Freddie Mac, the federal government will not allow the credit crisis to continue without significant market intervention. I would expect some form of federal action on this topic soon. Senator Dodd held a hearing related to this matter back in April and I would look for some federal legislation to arise now that Congress has returned from its summer recess. In addition, global settlements being reached with major investment banks by the collective states will result in restitution to the vast majority of holders of auction rate securities, including those collateralized by student loans. Thank you for your attention to this matter and I will answer any questions you may have on this issue.