

Back to School for Student Loans

■ A bill to make the government the primary lender to college students provokes the opposition of private lenders and Republicans.

The House student loan reform bill, touted as a measure to make college more affordable, is really about who gets the profits from originating federal financial aid—the government or banks. Proposed legislation would end federal subsidies to private lenders, thereby drying up a revenue stream that banks have enjoyed for more than four decades.

By Eliza Krigman

Sponsored by House Education and Labor Committee Chairman George Miller, D-Calif., the Student Aid and Fiscal Responsibility Act, known as SAFRA, would make Uncle Sam the sole originator of federal student loans. It's more efficient and reliable to lend directly from the government, said Robert Shireman, deputy undersecretary at the Education Department and a student-loan expert. President Obama called for the switch to direct lending in his 2010 budget proposal, and Miller's bill would make it law.

"We should be in the business of investing in students, not subsidizing banks," said Education Secretary Arne Duncan in affirmation of the bill. Supporters of the legislation call it a "commonsense" move that should have happened long ago.

Naturally, private lenders oppose the change. At present, banks originate and administer the majority of federal student loans. In the 2007-08 school year, \$52.5 billion in federal money ran through private lending and \$13.1 billion came directly from government lending. Private lenders face very little risk: The government guarantees their student loans against default and provides subsidies in the form of a "special-allowance payment." When a borrower's interest payments are not enough to cover the lender's guaranteed interest rate in a given financial quarter, the lender receives an SAP.

Under the Federal Family Education Loan program, created in 1965, private banks originated and processed federal student loans exclusively until the Clin-

ton administration. In 1993, the Student Loan Reform Act established the William D. Ford Federal Direct Loan program, which has co-existed with FFEL ever since. Most of the time, the choice between private and direct lending occurs at the college financial aid office. "Schools generally offer one or the other," said Justin Draeger, vice president of public policy and advocacy at the National Association of Student Financial Aid Administrators.

Universities that choose private banks, and most of them do, typically have a list of preferred lenders—a practice that led to abuses uncovered in 2007, when investigations revealed that private student lenders were bribing college financial aid officials to select them for preferred lender status. An explosive scandal ensued with almost daily revelations about unsavory relationships between banks and financial aid officials. In the aftermath, momentum grew to

take private lenders out of the equation.

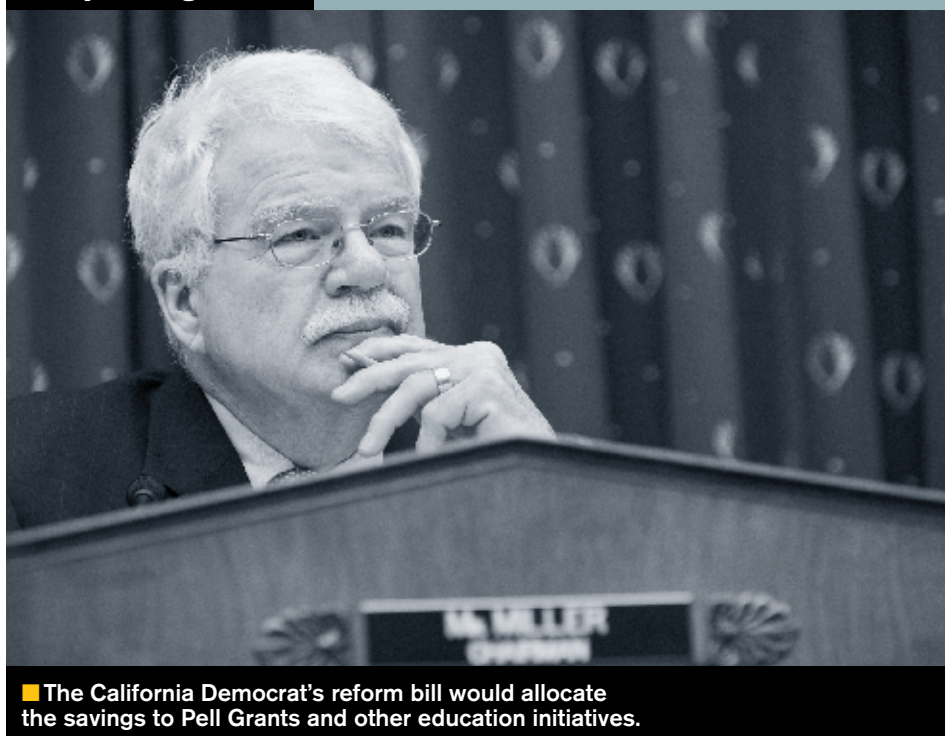
Companies originating loans through the FFEL program, however, maintain that competition and choice are essential for a healthy student-loan market. "When you have a monopoly providing a service, you get monopoly service levels," said Jack Remondi, vice chairman and chief financial officer of Sallie Mae. "Think of the Department of Motor Vehicles."

Private lenders say that their 75 percent share of the federal student-loan market is evidence that they provide better service than the direct lending program. Yet, no consensus has emerged from financial aid offices or students that private or direct lending offers better service.

Sallie Mae, originally a government-sponsored entity created to buy and service student loans, is now one of the leading private lenders; through its subsidiaries, the company manages \$180 billion in education loans and serves 10 million student and parent customers.

The Congressional Budget Office projects that a complete shift to direct

■ Rep. George Miller



■ The California Democrat's reform bill would allocate the savings to Pell Grants and other education initiatives.

lending would save up to \$87 billion over the next decade. The amount of savings is a bone of contention, however. At the request of Sen. Judd Gregg, R-N.H., CBO scored the legislation again, adjusting for the possibility of higher student-loan default rates through a loan-valuation process that experts say is a more accurate reflection of market risk. The new assessment cut the estimated savings to \$47 billion.

Under the Miller bill and the initial scoring, approximately half of the projected \$87 billion in savings would be slotted for Pell Grants for low-income students. Early education, historically black colleges, and community colleges would also benefit. Armed with CBO's second scoring, however, Gregg, the ranking member on the Senate Budget Committee, and Rep. John Kline, R-Minn., ranking member on the House Education and Labor Committee, raised concerns that the Miller bill would actually spend more than it is projected to save.

Firing back at the Republicans, Jason Delisle wrote in *Higher Ed Watch*, a blog at the New America Foundation, that the revised CBO estimate at the very least confirms that direct lending is significantly cheaper than the FFEL program, even if by a smaller margin than first thought. Delisle, who supports Miller's bill, was formerly a Republican staffer on the Senate Budget Committee.

In practice, the savings primarily comes from the profit the government would generate from the interest on student loans. That's an idea that doesn't sit well with some of the Senate Republicans on the Health, Education, Labor, and Pensions Committee. "Packing up this nation's successful student-lending program and sending it to Washington to be administered there is not what 12 million students and 4,400 universities have chosen to do," said Sen. Lamar Alexander, R-Tenn., a former Education secretary. "The Department of Education should not be a \$500 billion national bank."

The bill will also encounter resistance from Sen. Ben Nelson, D-Neb., whose state is home to Nelnet, another of the leading private lenders. As of March 2008, Nelnet had \$26.3 billion in net student-loan assets under management. Nelnet is one of four companies with

a federal contract that will allow them to continue servicing student loans under the proposed new regime even if they don't do any more lending. "Servicing loans" refers to the management of payment processing for the lifetime of a loan.

Among colleges and financial aid administrators, reviews of the Miller bill are mixed. A slew of university associations—including the American Association of Community Colleges, the American Association of School Administrators, and the American Association of State Colleges and Universities—have signed on to support it. The Friday the 13th Group, a collection of financial aid administrators named after the date of its formation, opposes a switch to all-government lending and has offered an alternative that would preserve FFEL. The financial aid officers' proposal, a hybrid of the current system and the Miller bill, would keep a role for private lenders in originating loans on the government's behalf and would shift to 100 percent federal funding for government loans.

Even if Miller's bill doesn't pass, private lenders could see a drop in customers because of fears, caused by the financial crisis, about the availability of funds. "By relying on private lenders, we actually faced the imminent collapse of student lending," Delisle said. "That's the inconvenient truth for the student-loan industry."

Indeed, when credit markets froze last fall, private banks were unable to raise capital for student loans and relied on the government for liquidity. Under the Ensuring Continued Access to Student Loans Act, passed in May 2008, the Education Department had the authority to purchase FFEL loans and provide private lenders with funding. But the law expires in 2010, and some schools cite that prospect as an incentive to switch to direct government lending.

Now that Miller's bill is out of committee, a House floor vote is expected in September. If the bill gets to the Senate, the Democratic leadership there will have to decide about moving the measure through budget reconciliation, which would require only 51 votes, or a regular

vote, under which obtaining a filibuster-proof 60-vote majority is unlikely.

With the multibillion-dollar student-loan industry on the precipice of a sea change, the voices of the borrowers—students, the *raison d'être* for the loans in the first place—have received little attention. "I am concerned that the president and Congress are not doing more to make college affordable for students," said Gregory Maynard, a senior at the University of Massachusetts (Amherst)

■ Sen. Lamar Alexander



■ "The Department of Education should not be a \$500 billion national bank."

who has an FFEL loan. Unfortunately for Maynard, this bill is unlikely to reduce his tuition costs.

While lawmakers, banks, and financial aid administrators jockey for their preferred arrangement of loan structures, Maynard and other college students return to school this fall with the same financial burden as before. But with school in session, the student voice on this issue may get louder. Christine Lindstrom, director of the higher-education program at the U.S. Public Interest Research Group, is planning several events with students this fall to raise support for Miller's bill and the additional grants it would provide. Lindstrom said, "We'd like to raise some Pell!" ■

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