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Despite Legislation, Parties Disagree on Whether Student-Loan 'Crisis' Has Ended

Fearing an election-year nightmare of students unable to find college loans, the Bush administration and Congress have moved with blinding speed, agreeing on and passing a student-loan bailout bill in less than a month.

And yet loan companies, colleges, and student-aid advocates are agreeing that the nation's student-loan "crisis"—to the degree there ever was one—won't necessarily end the moment President Bush signs the measure into law this week.

"Absolutely, the crisis is not automatically over once the president signs the bill," said Kevin Bruns, executive director of America's Student Loan Providers, an industry coalition.

Others endorsing that sentiment, though for different reasons, include representatives of the American Council on Education, the umbrella organization for the nation's colleges, and the U.S. Public Interest Research Group, which lobbies on behalf of student interests.

The student-loan companies say the law approved by Congress, giving Education Secretary Margaret Spellings the right to help lenders by paying cash for their loan portfolios, provides no guarantee of relief because Ms. Spellings is free to offer whatever price for their loans she deems appropriate.

College representatives such as Terry W. Hartle of the American Council on Education warn that even with the legislation, the most serious student-lending problem still concerns the escalating use of private loans—those offered by banks without any federal subsidy and thus largely outside the power of Congress to affect.

And student-aid advocates such as Luke Swarthout of the U.S. Public Interest Research Group contend that the bailout legislation is Congress's latest giveaway to loan companies, and that the bill does nothing to fix the structure of a system in which Congress, rather than the marketplace, sets the level of federal subsidy paid to the lenders.

A Complicating Message From the Fed

Further complicating matters is the question of whether the nation's top voice on monetary policy, Ben S. Bernanke, chairman of the Federal Reserve, has just taken sides and, if so, with whom.

Mr. Bernanke, in a letter to Congress dated April 25, days before final passage of the bill, suggested that lawmakers should devise "a more market-sensitive approach" to setting federal subsidies for student-loan companies. Lenders hailed that comment as a call for Congress to increase the subsidies the government pays on federally guaranteed student loans, while their critics saw the Fed chairman urging an end to the practice of Congress dictating the rate.

The legislation (HR 5715), whatever the sides may think of it, arrived on Mr. Bush's desk with astounding speed. It won final approval in the Senate and House of Representatives last Wednesday and Thursday, less than a month after the chairman of the House education committee, Rep. George Miller, Democrat of California, proposed it (The Chronicle, May 1).

Lawmakers acted after several weeks in which dozens of private lenders announced they would no longer participate in the government-backed loan program, through which the government uses subsidies and a guarantee of repayment to encourage banks and other lenders to offer student loans at below-market rates.

Congress had voted last September to cut about $20-billion from the subsidies the government pays to lenders, in an attempt to make the subsidy rate closer to the true cost of operations for most lenders. Lenders said the subsidy cuts, combined with a rash of mortgage defaults that drove up their own borrowing costs, made participation in the government program no longer affordable.

Nonbank lenders—including Sallie Mae, the nation's largest student-loan company, and dozens of state-run agencies—were regarded as the most vulnerable to the higher borrowing costs. That is because they do not have their own customer deposits, nor are they permitted to use the government-owned banks where commercial banks are allowed to present student-loan debt as collateral for cash advances.

The Federal Reserve took one additional step to aid the student-loan system on Friday, announcing that investment banks, which sometimes help lenders by purchasing packages of student loans, can now use student-loan debt as collateral when borrowing from the government.

That action was urged by Rep. Paul E. Kanjorski, a Pennsylvania Democrat who leads the House Financial Services Committee's subcommittee on capital markets. Mr. Kanjorski has been pressing repeatedly for government help to avert a student-lending crisis.

Some student-aid advocates have been describing fears of such a crisis as overblown. The loan companies that so far have announced their withdrawal from the federal program represent only about 14 percent of all government-backed lending in the current academic year, and no student in the country has so far been identified as unable to find a subsidized loan. In addition, the federal government runs its own parallel program, though which students at participating colleges can receive a subsidized loan directly from the Education Department, without using a bank.

Yet Congress, facing elections in November, was prodded into action not only by pressure from lobbyists for lenders and colleges, but by public alarm set off by articles in newspapers across the country warning of a crisis facing the nation's college students.

The Effect on Private Loans

The legislation awaiting the president's signature this week includes several provisions designed to help students, beyond giving the education secretary the authority to purchase loan portfolios from lenders.

It bolsters the federal government's "lender of last resort" program by letting the education secretary designate an entire college, during times of necessity, as a place where lenders are allowed to issue student loans with an additional layer of federal subsidy. It also increases federal grant aid for low-income students, raises the amount students can borrow each year under the federally subsidized program, and encourages parent borrowers by letting them defer repayment until six months after their children leave college.

Such steps could help lessen students' reliance on private loans, the fastest-growing segment of student aid from any source.

Interest rates in the government-subsidized loan program are set by law, meaning the banks rather than the students suffer from the higher cost of credit in the overall economy. But in the private student-loan market, companies are raising their rates and imposing tougher eligibility standards. Some students therefore are left unable to get the money they need to cover costs beyond the amounts they can borrow from the government-subsidized program.

The effect of that squeeze is falling most heavily on higher-cost institutions, mostly for-profit colleges and smaller private colleges. Some of the for-profit institutions are already responding. They include Corinthian Colleges, which is being more discerning in accepting applicants, working harder to find jobs for its graduates, and providing its own guarantees of student-loan repayment, said Trace A. Urdan, a senior research analyst for the investment bank Robert W. Baird & Co.

Mr. Hartle, who is senior vice president for government and public affairs at the American Council on Education, said that many higher-cost traditional four-year colleges may have to follow Corinthian's lead as they prepare for the start of classes in the fall.

Increase in Loan Limits

The increase in per-student loan limits granted by the bailout legislation will also help both students and colleges become less reliant on private loans, according to a report by Student Lending Analytics, a research and advisory-services company. The increase, by $2,000 per student per year, was the first "significant increase" since 1993-94, Student Lending Analytics said.

The current annual limit in the government-subsidized loan program ranges from $3,500 for freshmen to $5,500 for seniors. About 79 percent of dependent undergraduates and 45 percent of independent undergraduates were borrowing from the government program at maximum levels in 2006-7, Student Lending Analytics said.

Other studies, however, suggest that lower limits help students, by maintaining the pressure on colleges to hold down costs. "A real solution may be looking into new and innovative methods of financing rather than just bailing out student borrowers or the loan providers," the Center for College Affordability and Productivity, a nonprofit research group, said in a report published last week.

Still more questions about the need for the legislation were raised on Thursday, the same day the House gave the bill final Congressional approval, when the Rhode Island Student Loan Authority announced a bond sale for student lending, making it the first state-run agency to do so since September. The agency attributed the sale, which raised $64-million, to its record of financial management.

Other lenders had been pressing the Bush administration in recent weeks to authorize a government agency, the Federal Financing Bank, to pay for their loans at rates about a 10th of a percentage point higher than the rate many of them are now being offered on the open market. Administration officials announced on April 23 that they believed the agency did not have that authority, and instead endorsed the legislation initiated by Representative Miller.

Up to the Education Secretary

Passage of the bill leaves Ms. Spellings largely in the position of deciding whether the student loan "crisis" is over because she can now set the price the government will offer the lenders for their loan portfolios, said Sameer Gokhale, an industry analyst with Keefe, Bruyette & Woods.

"If the price set is too low, then the legislation serves no purpose because they'll still be exiting the business anyway," Mr. Gokhale said of the student-loan companies.

Investors seemed optimistic. Shares of several leading student-loan companies rose Friday, including stock in Sallie Mae, which gained 7.8 percent; Bank of America, which increased 4.9 percent; Citigroup, 4.2 percent; and JPMorgan Chase & Co., 3.4 percent.

But smaller lenders might not fare as well if Ms. Spellings sets the price for the government's purchase of loans by using a market mechanism, such as an auction, in which all lenders are forced to compete for the lowest possible price, Mr. Gokhale said.

Mr. Swarthout, a higher-education lobbyist for the U.S. Public Interest Research Group, challenged Mr. Gokhale's suggestion that using a market mechanism is a bad idea, and he observed that Washington policy makers, including Mr. Bernanke, increasingly appear to recognize the potential value of such a system. The loan industry's proposal for using the Federal Financing Bank to supply them with cash was "just an effort by them to set the subsidy rate" higher than the level approved last September by Congress, Mr. Swarthout said.

"This is an industry that has thrived based on its ability to get Congress to subsidize and oversubsidize its venture," he said, "and Bernanke is rightly identifying what any outsider with a basic economic understanding would see, which is you have a $50-billion or $60-billion a year enterprise where subsidies are set by Congress, and thus open to the influence of the very people who seek to profit from it."

Industry groups, which have fought against the introduction of any "auction" type of system for introducing market forces into the process of setting the federal subsidy rate, read Mr. Bernanke's advice on devising "a more market-sensitive approach" differently.

The federal subsidy rate for companies involved in government-guaranteed student lending is now based on "commercial paper," a fluctuating loan rate that is used by banks for industry transactions. Mr. Bernanke, in his letter to Congress, suggested that lawmakers "may well wish to revisit the question of whether setting a fixed spread over the commercial-paper rate is the best approach.

"You may decide that a more market-sensitive approach—flexible enough to provide a wider spread during times of market stress and a narrower one during normal times—could provide a more robust structure," Mr. Bernanke wrote.

Loan-industry officials, whose advocacy of a standard based on commercial paper led Congress to adopt it, see the Fed chairman's letter as suggesting only the use of additional indices in setting the subsidy rate, and not suggesting that lenders be forced to bid against each other.

Mr. Bernanke's goal "could be accomplished by referencing the spread between two financial indices maintained by Treasury or the Fed," said John Dean, a lawyer for the Consumer Bankers Association, which represents many of the nation's largest student-loan companies. "This approach would be market-sensitive and would not entail all of the many negatives of establishing a mechanism for an auction, operating it, and assuring its integrity."