

Congress Prepares for Student-Loan Crisis, While Declaring It Unlikely

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When Nelnet, the nation's No. 2 consolidator of student loans, announced in January that it would stop making consolidation loans, members of Congress didn't seem to bat an eye.

A week later, the College Loan Corporation, the eighth-largest originator of federally guaranteed loans, followed suit and said that it would stop making such loans. Once again, there was silence from Capitol Hill.

But when the Pennsylvania Higher Education Assistance Agency announced late last month that it would suspend its federal student-loan operations, Congress sprang into action.

Within two days, the chairmen of the Senate and House education committees, Sen. Edward M. Kennedy of Massachusetts and Rep. George Miller of California, both Democrats, had sent a letter to Education Secretary Margaret Spellings urging her to prepare for a potential crisis in access to federal student loans. Within two weeks, both chairmen had held hearings on the issue.

Several months into a credit crunch that has led at least 20 lenders to leave the guaranteed-loan program or suspend their lending operations, lawmakers have begun to respond with a sense of urgency—even as they seek to reassure students and parents that a crisis is unlikely and that federal student loans will still be available this fall. In the end, though, there may be little that Congress can do to shore up the federal student-loan system, beyond pressuring other government entities, like the Education and Treasury Departments, to take action.

Pheaa Marks Turning Point

To be fair, a few members of Congress had voiced concerns that credit-market disruptions could threaten the availability of federal student loans even before Pheaa's pullout.

Eleven days before the agency's announcement, Rep. Howard P. (Buck) McKeon, the top Republican on the House education committee, sent a letter to Ms. Spellings asking her to monitor the student-loan system. That same day, Rep. Paul E. Kanjorski, a Pennsylvania Democrat who chairs the House Financial Services Committee's subcommittee on capital markets, wrote to Ms. Spellings and Treasury Secretary Henry M. Paulson Jr. asking them to consider using the Federal Reserve, the Federal Financing Bank, or the Federal Home Loan Bank System to increase liquidity in the student-loan markets.

But it was not until Pheaa, the largest of the state-based nonprofit loan agencies, announced that it was temporarily withdrawing from the federal student-loan market that Congress's Democratic leaders really took notice.

Until then, only for-profit lenders had withdrawn completely from the federal program (although state-based lenders in Indiana, Missouri, and Iowa had announced in the previous weeks that they would stop making consolidation loans), and "most people were assuming that organizations as large and as strong as Pheaa could always find money to provide loans," said Harris N. Miller, president of the Career College Association, which represents for-profit institutions.

After Pheaa's announcement, "a lot of skeptics of the lenders' arguments about student-lending liquidity problems ... began to realize they were wrong," he said.

Like many lenders that have exited the federally guaranteed loan program, Pheaa had relied on the asset-backed

securities market to finance its loans. That market has dried up in recent months, leaving some lenders without enough money to continue making student loans.

Theoretically, nonprofit lenders like Pheaa should have an easier time than for-profit ones in obtaining capital because they are exempt from paying income taxes and receive a higher subsidy rate from the federal government.

Such advantages are typically viewed as a form of "credit enhancement" that reduces the risk of the lender defaulting on its obligation to pay the investors interest, said Mark Kantrowitz, publisher of FinAid, a Web site about student aid. Among today's jittery investors, though, "that doesn't seem to be helping much," he said.

The departures do not seem to be having an effect on student-loan availability, in part because banks—which do not depend on the asset-backed-securities market to finance their loans—have stepped in to fill the gaps left by nonbank lenders. Both Congress and the Education Department believe they will continue to do so.

Some lenders aren't so sure. They say subsidy cuts enacted by Congress last year have cut into lenders' profits so deeply that some banks are becoming reluctant to expand their student-lending operations. This month Joe Belew, president of the Consumer Bankers Association, sent a letter to Congress warning that banks "cannot continue to devote ever larger amounts of capital to making loans that lose money or barely break even."

In light of this, some lenders are urging Congress to roll back the subsidy cuts to make student lending more attractive. But even supporters of that idea acknowledge that Congress is unlikely to do it, given the high cost.

Congress has already dedicated the \$20-billion in savings generated by the subsidy cuts to increases in student aid.

A Federal Bailout?

Instead, lawmakers and lenders alike are focusing their efforts on the increasingly popular private student-loan market, where the effects of the credit crunch have been the most pronounced.

Most of the proposed legislative solutions focus on reducing borrowers' dependence on private loans. An aide to Mr. Kennedy has said the senator will propose legislation to expand eligibility for federal loans, and an aide to Mr. Miller has said he is weighing a temporary increase in federal borrowing limits.

While neither lawmaker has offered a specific bill, the Career College Association is urging them to raise loan limits in the unsubsidized Stafford Loan program and provide a PLUS-type loan for independent students. PLUS loans are now available only to parents of undergraduates and to graduate students.

Neither of those fixes, however, would get at the root cause of the problems in both federal and private lending: the frozen credit markets. Until those markets recover, lenders like Pheaa will continue to face financing difficulties.

Experts say there is little Congress can do on its own to inject liquidity into the capital markets. But it can play a role by urging the Treasury Department and the Federal Reserve to intervene in the student-loan market, and by pressing the Education Department to prepare for a potential crisis.

So far the chairmen of the education committees have focused on the Education Department, urging the secretary to test-drive its "lender of last resort" program and ensure that the federal direct-loan program is prepared to handle an influx of borrowers if more lenders abandon guaranteed loans. Under a "lender of last resort" program, guarantee agencies the nonprofit entities that repay lenders in cases of default could lend directly to students who were unable to get loans from a traditional lender.

Since sending their letter, in February, Mr. Miller and Mr. Kennedy have ramped up their criticism of the secretary, accusing her of not acting with enough urgency. At a hearing this month, Mr. Miller pressed Ms. Spellings to do more to ensure that guarantee agencies are prepared to step in if traditional lenders stop making loans to students who pose a high risk of defaulting.

"I want to know that the plans will be operational if you get that 3 a.m. call," said Mr. Miller, alluding to the now-famous presidential-campaign ad for Hillary Rodham Clinton.

"We will be ready," Ms. Spellings promised.

Mr. Kennedy and Mr. Miller have not sought help from the Treasury or Federal Reserve yet, perhaps because the lawmakers remain confident that the markets will correct themselves.

But last week, Mr. Kanjorski and 31 other lawmakers, many of them from Pennsylvania, sent a letter to the Federal Reserve's chairman, Ben S. Bernanke, urging him to use his emergency authority to open up the Reserve to securities firms and other nonbank lenders in the guaranteed-loan program.

The letter, which was sent a day after the Federal Reserve agreed to provide a \$30-billion line of credit to help JPMorgan Chase acquire the troubled investment bank Bear Stearns, also asks the Federal Reserve to allow investment banks to borrow from a new \$200-billion lending pool, using student-loan securities as collateral.

The effort was welcomed by Scott Miller, Pheaa's chief lobbyist in Washington.

"A little public pressure can't hurt," he said. "If the Fed can bail out Bear Stearns, they can bail out student loans."