The Student Loan Swindle

An interview with Professor Alan Nasser

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MW–Is it possible to "walk away" from a student loan and declare bankruptcy?

Alan Nasser— No, it's not possible for student debtors to escape financial devastation by declaring bankruptcy. This most fundamental of consumer protections would have been available to student debtors were it not for legislation explicitly designed to withhold a whole range of basic protections from student borrowers. I'm not talking only about bankruptcy protection, but also truth in lending requirements, statutes of limitations, refinancing rights and even state usury laws – Congress has rendered all these protections inapplicable to federally guaranteed student loans. The same legislation also gave collection agencies hitherto unimaginable powers, for example to garnish wages, tax returns, Social Security benefits and -believe it or not- Disability income. Twisting the knife, legislators made the suspension of state-issued professional licenses, termination of public employment and denial of security clearances legitimate measures to enable collection companies to wring financial blood from bankrupt student-loan borrowers. Student loan debt is the most punishable of all forms of debt – most of those draconian measures are unavailable to credit card companies. (Maybe I'm being too harsh. Sallie Mae recently announced that it will after all forgive a debt under either of two conditions: in case the borrower dies or becomes totally disabled.)

MW–Is it fair to say that the student loan industry is a scam that targets borrowers who will never be able to repay their debts? Are these students like the people who were seduced into taking out subprime loans? How much money is involved and how much of that money is either presently in default or headed for default?

Alan Nasser—It's as fair as fair can be. First, the student loan industry is huge – a large majority of students from every type of school are in debt. Debt is held by 62 percent of students enrolled at public colleges and universities, 72 percent at private non-profit schools and 96 percent at private, for-profit ("proprietary") schools. It was announced last summer that total student loan debt, at $830 billion, now exceeds total US credit card debt, which is itself bloated to the bubble level of $827 billion. And student loan debt is growing at the rate of $90 billion a year. So we're not talking small change.

How many of these students are subprime borrowers? That is, how closely do student loans resemble junk mortgages? The answer hinges on three factors: how these loans are rated, how likely the borrower is to repay, and the default rate on student loans.

The ratings of student loans are supposed to reflect the "health" of those loans, defined as the likelihood that the borrowers will default. This is officially measured by what is called the "cohort-default rate", a very poor instrument because it measures only defaults during the

first two years of repayment. What we want is data on lifetime defaults. The Department of Education collects the relevant data, but has misrepresented the facts in its public statements.

In September 2008, then-Secretary of Education Margaret Spellings announced in a news release that default rates on federal loans were “historically low”: only 5.2 percent of recent grads were in trouble. Spellings used the cohort-default rate to arrive at this figure. But the Department’s Inspector General Office employed a more realistic method in its 2003 audit, which calculated lifetime risk. It estimated that over their lifetime between 19 and 31 percent of college freshmen and sophomores would default on their loans (depending on the type of loan and when it was taken on). For community college students, the prospects were grimmer still: between 30 and 42 percent were expected to default. And the future was most discouraging for students at for-profits: between 38 and 51 percent were anticipated to default.

You can see that the default rate among student borrowers is expected to be higher than that for subprime home mortgages.

You might think that these alarming figures would motivate the feds to conduct checks to better assess the creditworthiness of would-be borrowers. But federal loans are doled out with no assessment of whether the borrower will be able to repay. Private lenders do no better. In recent years they have taken to “direct-to-consumer” loans. Loans marketed directly to students typically have higher interest rates and are of course not overseen by the college’s financial aid office. These loans are enormously profitable. In 2007 alone, one company reported making more than $1 million in such loans to Seattle University students. The financial security of the borrowers was of no interest to the lender.

That student borrowers will in fact be in a position similar to subprime mortgage debtors is also indicated in the Bureau of Labor Statistics December 2009 projection of job growth over the next ten years. Most of these jobs will be low paying and will not require a bachelor’s degree.

And don’t think that predatory lenders market loans only to actual students. Potential students are targeted as well. A major mantra nowadays is that the best protection against unemployment is a college education, which has led some private lenders to recruit borrowers……at the unemployment office!

There are a whole lot of subprime student loans out there hanging like a sword of Damocles over the heads of very many college students and grads.

Since the original article appeared, I’ve received an avalanche of comments and stories from former and current students relating their often tragic stories. Here is a representative letter, whose author gave permission to use his name:

“My name is Luther Callahan and I am one of the many many students who believed in the dream of being highly educated in order to provide a good life for my family. Well…my wife and I believed believed in this. I can not find gainful employment. My wife has been furloughed on her job and has not received a raise in five years.

We don’t expect anyone to give us anything this is why we went out and got educated. However, everyone is more than willing to take what we do not have (money). Student loans

are due and we can not pay them all. We are receiving the standard threats and are at our wits end as to what to do. Where are the solutions? What is in the works that will alleviate student stress?

Some of the heartless employees of these banks ask outlandish questions like “what was your plan for paying the money back?” I would tell them I did not plan for there to be a global financial meltdown. I had no idea that this would occur. I did not plan for there to be employment freezes and massive layoffs and cuts within my state. We are at a loss and these banks are poised to take everything.”

MW–How is the government assisting this scam?

Alan Nasser—We’ve just seen one way that government aids and abets the lenders, by fudging default rates. But government’s participation in this rip-off goes deeper than that. The Department of Education has its own loan program and, accordingly, a positive interest in defaults. It makes a financial killing on its recovery of defaulted Federal Family Education Loan Program (FFELP) loans.

In a revealing Wall Street Journal Report (“US Gets Tough on Failure to Repay Student Loans – Education Department Wields Heavy Hand in Some Hard-Luck Cases – No Breaks in Bankruptcy Court”, Jan. 6, 2004) John Hechinger reveals that for every dollar the Education Department pays out in default claims, it is able to rake back the entire principal, plus almost 20 percent in interest, penalties and fees. And keep in mind that the value of the default portfolio includes not merely principal plus interest at time of default, but also the interest that continues to accrue after default. Let’s bring this up to date with a glance at Table 4 in the Supplement to president Obama’s 2010 budget. We find that the most recent recovery rate -the amount recovered compared to the amount of the defaulted loan- for defaulted FFELP loans is 122 percent. This is the highest recovery rate for all types of federal loan, and more than twice the rate for the next highest loan category. You get a sense of the relative enormity of Uncle Sam’s looting binge when you look at the recovery rate for credit card defaults – about 25 cents on the dollar.

Alan Collinge of StudentLoanJustice.org has shown that the Department of Education makes more on defaulted loans than it does on loans in good stead. Washington has just as much an interest in encouraging student loan defaults as do, for example, collection companies, which obviously live off defaults. This is exactly what the first president Bush meant when he declared his intention to “run government like a business.” Government itself has become a predatory lender. It has the same incentive to benefit from default as do private lenders.

MW– How do private loan companies benefit from defaults?

Alan Nasser—Here, briefly, is what gives private companies a more than casual interest in default. It was Congressional legislation that screwed students to the benefit of holders of defaulted loans. Legislators put in place a new fee system which permitted holders of defaulted loans to appropriate 20 percent of of all payments from debtors before any of those payments are applied to principal and interest. Because Congress chose to withhold key consumer protections from student borrowers (for details, see below, question 4), the latter are virtually forced to enroll in “loan rehabilitation” programs. The borrower is subject to a form of extortion, whereby (s)he essentially buys her way out of allegedly more severe penalties with payments that are rarely applied to principal or interest on the defaulted

loan. These outlays are in effect the price of access to a substitute loan, accompanied of course by additional fees. The new loan is typically larger than the defaulted one. Much as the limp “regulations” on the financial sector deliberately leave room for the kind of risky trading that is likely to bring about a repeat of the September 2008 debacle, the “rehabilitation” process makes it more likely that the debtor will default again.

The fee system is at the heart of the private lenders’ affection for default. It gives to loan guarantors the same kind of interest in default that is so obvious in the case of collection companies. Collinge has analyzed IRS filings of guarantors of federal student loans. It turns out that guaranty agencies average about 60 percent of their income from fees alone. If the default rate declines, so do the fees and income of the guarantors.

The biggest private lenders, like SLM Corporation (Sallie Mae) and Citigroup, have interests comparable to the guarantors’. This is because the latter, as well as some of the biggest collection agencies, are themselves often owned by the lenders. The lender, guarantor and collector thus form a system of interwoven interests: a lender defaults a loan, which then becomes bloated with collection fees, which then generates a flow of revenues to the guarantor and the collector. If the latter two are owned by the lender, we have income continuously flowing to all three – provided that borrowers continue to default, which is made more likely by the process I just described.

Sallie Mae’s 2003 annual report draws a vivid picture of the vast profits made on defaulted loans. The company set an earnings record that year, and the report is explicit that collections on defaulted loans were the golden goose. The company’s 2005 annual report shows that its managed loan portfolio grew by 87 percent between 2000 and 2005. In that same period its fee income grew by 228 percent.

MW–Are former and active-duty members of the military being targeted?

Alan Nasser—I mentioned earlier that 96 percent of students at for-profit schools have taken student loans and that these students are, according to Department of Education studies, most likely to default. These schools target the military market with an aggressive and highly successful recruitment campaign. High numbers of active duty and recently discharged military personnel attend for-profits. 29 percent of military enrollments are in the for-profit sector, and 40 percent of annual tuition assistance to veterans winds up going to proprietary schools. Data from the US Army and Defense Department show that the University of Phoenix, the largest university in North America, is the third largest receiver of education funding from the US Army.

Military personnel are often targeted while still enlisted. They are attracted to the relative ease with which they can attend school, often at night, on the weekends, or for active-duty military, even while deployed. With the recent reduction of troops in Iraq, more service members are returning to the United States. Waiting for them are generous G.I. Bill benefits that allow them to pursue vocational or baccalaureate degrees at accredited colleges. The for-profit sector is poised to corner that market as public institutions squeeze their enrollments, raise tuition and watch public support of higher education dwindle in the current resurrection of pre-Keynesian economic policy.

The job prospects for military personnel at for-profits are predictably poor, which of course contributes to the unmanageability of the substantial debt that many of them incur. A Bloomberg report quotes a retired Marine Corps Colonel who now directs human resources

for U.S. Fields Operations at Schindler Elevator Corp., as saying "we don't even consider" online for-profit degree-holding candidates for the company's management development program.

MW–Why haven't the victims of these toxic loans used social networking and campus organizing to fight back against this ripoff? Are there grounds for a class action suit? What about organizing a collective action to withhold loan payment for one month to send a message to the banks?

Alan Nasser–There have been isolated instances of efforts to educate and mobilize. My and Kelly Norman's original article has been made into a booklet by an Indiana University faculty member, for distribution to the student body. And many readers have forwarded the article to their circle. But the key to effective resistance is organization, and the most likely initiators of organization, the left-of-liberal Left, remains dormant. We can't even get it together to mobilize an antiwar movement in this age of official permanent war.

During the period of widespread student opposition to the Vietnam war there were intercampus communications networks that helped to bring about nationally coordinated demonstrations and draft resistance. A comparable network, organized around the student debt crisis, could be formed if a few campuses got the ball rolling by developing student and faculty organizations dedicated to informing and mobilizing students and those in solidarity with them to resist debt predation. Your suggestion of a payment moratorium is a good one. One of its chief benefits in my opinion would be to draw attention to the issue as a catalyst for the ultimate development of a broader resistance to the entire regime of austerity and debt peonage that the vested interests are imposing on working people.

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