US: Largest student lenders halt private, consolidation loan programs

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Following other major lenders, Bank of America, one of the largest student loan issuers, announced April 17 it would no longer offer private student loans because of the ongoing breakdown in the US bond market. Although BoA did not estimate how many students would be affected by the move, the bank's private loans accounted for a quarter of its student lending last year, or about $1.1 billion.

The decision signifies the deepening crisis in the financial sector and is an indication of the compounding economic difficulties for working people in the coming months as prices rise, jobs are cut, and credit evaporates.

BoA's announcement came only days after the top student lender, Sallie Mae Corporation, reported a first-quarter loss and pulled out of the federal loan consolidation program citing "severe credit market deterioration," and Citigroup's student loan operations cut funds to students at many less expensive universities.

In all, 57 lenders have announced they are halting various lending operations so far this year. Many other organizations have raised interest rates and implemented restrictions on borrowing standards, to the exclusion of younger, poorer students.

The constriction of student lending will have devastating consequences for millions of students already saddled with tens of thousands of dollars in education debt, while college costs continue to grow and economic prospects deteriorate.

Rising college costs, stagnant government aid, and loosened lending regulation over the past decade precipitated the growth of the private loan industry, to which a growing proportion of the student population turned for college funding.

The College Board put total average costs of college including tuition, fees, and books for the 2007-2008 academic year at more than $17,300 for the in-state public university student, and nearly $35,400 for students at private universities. As grant aid and state-level education funding is slashed, these costs are set to rise by thousands of dollars over the coming year.

The student loan crisis is bound up with the subprime and credit crises. Loan companies typically bundle together loans and sell the packages on the bond market to investors, then use the money to originate new loans. The student loan bonds are guaranteed in many cases by third-party organizations.

In the case of Bank of America, the private loans were packaged and sold by the investment firm First Marblehead Corporation. According to the company, First Marblehead did not complete a single bond deal in six months.

First Marblehead's student loan bonds were backed by The Education Resources Institute (TERI), the largest private student loan guarantor. In a statement April 7, TERI announced it was filing for Chapter 11 bankruptcy. The organization said the bankruptcy was precipitated by "Mounting difficulties in financing the securitization of private education loans, along with a rise in borrower defaults and delinquencies brought on by a slow economy, [which] adversely impacted TERI's liquidity."

Student loans were until recently considered a relatively secure investment on the bond market, because student borrowers re-pay their debts fairly consistently. In the wake of the subprime meltdown and as job prospects for college graduates worsen, however, even federally guaranteed bonds are now viewed as risky.

Because the First Marblehead bonds could no longer be insured against default, BoA cut its ties and announced it was ending private lending. BoA's business accounted for some 15 percent of First Marblehead's annual revenue.

In addition to the closure of private lending, Citigroup's Student Loan Corporation announced it was suspending lending at schools with lower graduation rates and withdrawing from participation in the federal consolidation loan program. Last week, the company said it would cease operating in these areas, "where loans with lower balances and shorter interest-earning periods result in unsatisfactory financial returns."

Consolidation loans allow borrowers to combine various loans under a single, fixed interest rate, making them relatively more manageable. The consolidation market amounts to more than $50 billion, representing a major portion of federal lending.

On April 12, Sallie Mae also announced it was halting consolidation loans, saying they were cutting into profitability. In fiscal year 2006, the company's originations accounted for well over a quarter of total consolidation loan volume.

So far, according to an April 17 report in the *Wall Street Journal*, nearly 50 providers of federally guaranteed loans and some 20 private lenders have quit consolidating loans. According to the financial aid web site FinAid.org, two-thirds of the federally backed lenders have left the consolidation market in the past few months.

In response to the collapse in lending, Congress has introduced legislation that would essentially throw money at the private loan industry. Under a Democrat-sponsored House bill, which passed 383-27 April 18, the Department of Education would be granted authority to buy up private student loans, thereby flushing federal money into the lending industry.

The bill, the "Ensuring Continued Access to Student Loans Act," would also enable the department to use its own discretion in advancing federal funds to guaranty agencies that insure the student loan bonds, which the bill says could serve as "lenders of last resort." In the Senate, Massachusetts Democrat Ted Kennedy has introduced a similar bill widely expected to pass that the White House has indicated it supports. While the bill would raise the cap on federal loans to $31,000 for undergraduates and $57,000 for graduate students, it does not extend the lower-interest rate federal loan program to cover students who are currently forced to rely on predatory private loans.

More fundamentally, the bill does absolutely nothing to contend with rising student indebtedness. In fact, as the name of the bill indicates, it seeks to prop up the debt market while aiding students as little as possible.

Some sections of the political establishment, particularly among the Democrats, have pushed for even more direct handouts to the loan industry. Democratic Senator Christopher Dodd of Connecticut, the Senate Banking, Housing, and Urban Affairs Committee chair, called for a bill to allow the Treasury Department to inject further federal funds into banks for the purpose of student lending—a proposal preferred by the private loan industry, because banks would not be required to spend the money on any existing loan programs.