Wall Street turns profit in student loan debt

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For the one in five Americans with student loan debt, it is a hellish nightmare. To others, it is an investment opportunity. Last week's news on student loans provided a glimpse on both sides of this growing divide.

First, there were the sequester budget cuts, implemented by means of a phony crisis generated through the collusion of the Democrats and Republicans. The cuts will hit low-income students by reducing Federal Work-Study and Supplemental Educational Opportunity grants by about $86 million. Loan fees will go up and student aid administration funds will be cut. Some financial aid already granted will be withdrawn, forcing students into additional loans.

Then the fourth quarter 2012 statistics from the Federal Reserve Bank of New York came out, showing student debt tripling over the last eight years. It found that 43 percent of 25-year-olds had student debt in 2012, an increase from 27 percent in 2004. Even more disturbing is the fact that a staggering 35 percent of people under 30 who have student loans are at least 90 days late. For all student borrowers currently in the repayment process, nearly 30 percent are delinquent, giving student loans a higher delinquency rate than any other loans, including credit cards.

Pointing to another aspect of the crisis, a report from research group Demos warned of the debilitating effect of poor credit on job seekers. Not only are millions of people unable to pay their college loans, but precisely because they are struggling under a mountain of debt, their ability to find work is severely impacted. Presently 47 percent of employers conduct credit checks before hiring, according to the study. The decision to hire even for low-wage entry-level positions such as maintenance work, telephone tech support, delivery driving, supervising a stockroom or food service now routinely involves a credit check.

With more than half of recent college graduates either unemployed or underemployed, and with average yearly incomes of 25- to 34-year olds with a degree down about $10,000 since 2000, it is no wonder there are staggering levels of loan defaults.

But no matter how difficult debt may be, in 21st Century capitalism it is someone's investment opportunity. And the riskier the debt, the greater the possible return. There is money to be made—a lot of it—when there is $1 trillion worth of debt.

Last week's news on the other side of the financial divide was therefore far more sanguine. Former government entity turned student loan originator, collection agent and debt seller Sallie Mae (SLM) announced that it had sold $1.1 billion worth of new student loan debt securities. The publicly traded firm also noted there was a whopping 15 times more demand for the highest-risk, highest-return batch than there was supply.

The *Wall Street Journal* commented that "boom times may be back for the student loan market" as "investors' hunger for risky loans shows the lengths they are willing to go to generate returns in a period when interest rates are hovering near record lows." Since the announcement of the Obama administration's quantitative easing (QE3) last September, there has been a decided uptick in the purchase of student loan securities. In 2012, SLM sold $13.8 billion worth of these bonds, making $514 million in the fourth quarter, a 12.5 percent increase over the previous year.

This current market frenzy for student loans is a product of the policies of the Obama administration. On the one hand, he has overseen the continuing record demand for student loans by implementing budget cuts to education and financial aid. On the other hand, the administration is pumping $85 billion a month into Wall Street, driving up the prices of financial assets as capital searches for investments.

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The market in securitized loans known as SLABS (Student Loans Asset-Backed Securities) was first created in 1992 by the Sallie Mae Marketing Association. SLABS rocketed in popularity with the asset-backed security scam, growing from $75.6 million in 1990 to $2.67 trillion at their height. While overall securitization levels have diminished, private student loans (with generally higher interest rates than government direct loans) from such lenders as Sallie Mae and Discover are still packaged into bonds and sold to institutional investors.

About $11 billion worth of SLABS were created in each of the last three years. This year through February, dealers sold $5.6 billion of student-loan-backed securities, more than triple the figure for the same period in 2012, according to Asset-Backed Alert.

Of the $1 trillion in student loan debt, between a quarter and a third is now securitized into SLABS. As with the subprime racket, SLABS are often bundled with other kinds of loans for trading purposes.

These financial instruments may now be set to proliferate substantially. Last week, The Wall Street Journal reported that an online securities trading company named SecondMarket has unveiled a new series of products to facilitate student loan debt speculation. Created in 2004, SecondMarket, with the tagline “the reinvented stock market,” became the conduit for Facebook, Twitter and LinkedIn to sell privately owned stocks amongst the well heeled. The company operates in the arcane trading world of bankruptcy claims, structured products, illiquid public equity, restricted securities, warrants, unregistered stock, convertible debt, and employee stock options.

The new mechanism will give SecondMarket's vetted base of “high net worth individuals,” hedge fund managers and institutional investors access to SLABs issued by agencies like Educational Funding of the South (EdSouth) and other student loan securities issuers. SecondMarket notes that while only a small number of investors have participated in student loan offerings in the past, their organization will facilitate the development of this niche.

The new platform will provide an opportunity to bet both ways on the debt, either with Sallie Mae & Co. or to “short” the industry and bet on cascading defaults, as hedge fund manager John Paulson did in the mortgage crisis. Either way, investors are looking to cash in on the unrelenting growth of student loan debt and its financialization.

Other recent student loan debt news includes the following:

• A number of schools are taking the unprecedented step of suing their own former students for defaults on Perkins loans. Yale, the University of Pennsylvania and George Washington University have begun taking defaulters to court. According to research by Bloomberg News, student loan debt collectors earned nearly $1 billion in commissions in 2011.

• The just-released State Higher Education Finance (SHEF) study reports a 25-year low in state and local support for higher education, the result of an additional decrease of 9 percent in 2012. Budget cuts have drastically affected the “new normal” in state funding for public education, the study explains. The student share of higher education costs is now 47 percent, a new high. The report states that they expect students and their families “to continue to make increasingly greater financial sacrifices in order to complete a postsecondary education.”

Relatively unreported has been the developing crisis among parents and grandparents who have co-signed student loans. This debt has spiked more than fivefold since the beginning of 2005, making the group of debtors aged 60 and older the fastest growing segment being hit by the crisis. This has resulted in a growing number of Social Security garnishments on behalf of the Department of Education. According to Treasury Department data cited by The *New York Times*, nearly 119,000 seniors age 60 and older were garnished as of last year.

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