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After Bill, Still Plenty of Room for Student Lenders to Profit

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By Joe Adler

WASHINGTON — As Congress moves to enact a bill this week that would kill government subsidies for private student lenders, companies that relied on Uncle Sam must dramatically reposition themselves to stay competitive, observers said Monday.

The House passed a health-care reform package on Sunday that included a bill to end banks' involvement with the Federal Family Education Loan Program, which made lenders the middle man for providing government-backed student loans. The Senate is expected to follow suit later this week.

The bill is likely to force lenders now participating in the federal program to shift to marketing loans to students not eligible for FFELP and toward a heavier reliance on loan servicing for income.

"Clearly, there are more kids going to school, unemployment outlook is high and tuition is still going up," said Teddy Downey, a policy analyst with Washington Research Group, a division of Concept Capital. "Eventually the government is not going to be able to fund increases in loans and grants as much because it's going to have fiscal restraints, and more people will turn to private lenders."

To be sure, the industry has not thrown in the towel and continues to press for changes to the legislation. The Senate this week plans to debate the reconciliation bill, which includes the student-lending reforms and the health-care overhaul changes passed by the House. Some observers said there may be an attempt to amend the House version by including an alternate industry proposal on student loans, which would allow lenders to receive fees for service.

John Dean, a counsel for the Consumer Bankers Association, said since enough lawmakers have lined up in support of health care that leaves room for focused debate on the student loan provisions in the Senate. "Health care has now passed, so if the Senate were to modify the reconciliation bill, … tweaking it somehow to preserve a more meaningful private-sector role, it would not kill health care," he said. "The sensitivity in the House was so great because any 'no' vote was seen as a vote against health care."

But Downey said that was unlikely. He said that any student loan modifications in the Senate would mean the House would have to vote again on the bill, potentially threatening other sections. (Unlike other legislation, reconciliation only requires the backing of a majority of senators, and that majority has already pledged its support.)

"Obviously there's a huge hurdle in getting that actually passed, the biggest being no Democratic senator in their right mind wants to make any changes to the bill to force the House to vote again on it," he said.

If the industry loses, lenders could begin focusing business on borrowers who would otherwise not be eligible for the FFELP loans, which generally offer more desirable rates.

"The lenders obviously won't be able to make federal loans, but they can continue to make private student loans, and it seems clear that there is remaining capacity there," said Mark Kantrowitz, the president of MK Consulting Inc. and publisher of FinAid.org and Fastweb.com. "There are situations in which students are not eligible for federal student loans, and obviously private student loans are one of their main options at that point."

Kantrowitz said that the current bill has a silver lining for the industry in that it lacks a provision from a prior version that would have expanded spending on Perkins loans from $1.5 billion to $6 billion a year. Such an increase would have meant just another obstacle to private lenders.

"That $4.5 billion increase would have come out of private student loans," he said.

Exactly how many lenders will be affected by the bill remains unclear. The vast majority of loans in the program — 98% — are held by just 100 lenders.

But many banks "read the writing on the wall" when the Obama administration proposed cutting the subsidies last year, Dean said.

"The student loan industry is not monolithic," he said. "It's a combination of federal student loans and private nonfederal student loans. A large part of the industry will continue to implement revised business plans that are now focused on the private student loans."

Dean pointed out that the bill allows a select few student loan leaders such as Nelnet and the Student Loan Marketing Association — better known as Sallie Mae — to keep existing contracts with the Department of Education to service federal loans, although further such contracts with private for-profit lenders are barred. He said that FFELP lenders would still get to keep loans in their portfolio originated before congressional action.

"The outstanding FFELP loans will remain outstanding, so you're not going to have a cliff where it goes from billions to nothing," he said.