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Mitt Romney's student loan plan criticized

Would allow private lenders back into market

By Tracy Jan
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WASHINGTON — Mitt Romney promises to usher private lenders back into the federal student loan market in a bid to decrease default rates and increase efficiency if he becomes president, but such a move could cost taxpayers tens of billions of dollars over a decade without saving students money, according to several higher education analysts.

The prime beneficiaries, critics say, would be banks and loan companies that stand to reap a financial boon through subsidies to make nearly risk-free, government-backed loans. They are the same firms that benefited from the system that existed for decades before 2010, when President Obama required that the government issue all federal student loans.

"The old guaranteed loan program was rife with lobbyists and will go down in history as a system that existed far longer than it needed to simply because it was enriching private companies," said Jason Delisle, director of the Federal Education Budget Project at the New America Foundation, a nonpartisan think tank. Inviting private lenders back into the program, he said, appears misguided: "What's in it for students or taxpayers? Nothing."

Private lenders, however, argue that Obama's move in 2010 cost the industry thousands of jobs as companies went out of business or shut down divisions that dealt with the servicing of such loans. And the Romney campaign says reintroducing private competition would spur innovation that could help prevent students from borrowing more than they should.

The current market for loans to help students and parents pay skyrocketing tuition rates is dominated by government-backed loans made exclusively through the Department of Education's federal direct loan program. In addition, the private market offers more loan options with no such backing — typically at higher interest rates. Before 2010, private firms also made government-backed loans.

'Romney's idea doesn't deal with the bigger problem.'

Romney has long had financial ties to the student lending industry, a lucrative sector that has come under intense scrutiny in recent years because of some questionable practices.

The sector has contributed more than $29,500 to Romney's campaign this election cycle, making him the top recipient of all candidates, presidential and congressional, according to the Center for Responsive Politics. In comparison, Obama, who ranks ninth, has received $5,250 from student loan companies.

The industry's top campaign contributors — SLM Corp., NelNet Inc., and College Loan Corp. — have donated to Romney but have not given to Obama. SLM Corp. owns Sallie Mae, a former government-sponsored enterprise that began to privatize in 1996. Though it now provides only private loans, it remains the largest originator of federal loans that until 2010 made up the bulk of its business.

In 1991, when Romney was chief executive of Bain Capital, the venture capital firm invested in EduServ Technologies, a now-defunct Minnesota company that processed student loans.

“Here’s a guy putting out an education policy that’s essentially putting the middleman back in for an industry that he used to have financial ownership in,” said Ty Matsdorf, senior adviser at American Bridge, a Democratic super PAC.

Romney’s plan for student loans, embedded in a 35-page white paper on education reform, is largely devoid of details. Other than criticizing Obama for driving away private lenders, Romney has not addressed why he would like to allow private lenders to make federally insured loans once again. But his campaign flatly denies charges that Romney was motivated to make the changes to enrich private companies.

Bill Hansen, a Romney adviser on higher education policy, said in an interview the presumed Republican nominee does not intend to replicate the old system, which entailed the government paying banks billions of dollars in subsidies and fees to cover their exposure in making student loans at low rates.

Although Hansen said new private programs would not necessarily be government-subsidized, he added that the campaign has yet to discuss the parameters, so it remains unclear how much money Romney’s plan would cost or save.

“The bottom line is we’re trying to design a better program that would hold default rates down, holds excessive borrowing down, and creates a better marketplace to help students and families, and not be so government-centric,” said Hansen, former deputy secretary of education under President George W. Bush and chief executive of Madison Education Group, a Virginia-based consulting company. “The current framework is a one-size-fits-all government solution that will never be customer-friendly and is totally subject to the political winds of the day.”

He said private lenders, working with nonprofits and state agencies, often did a better job than the federal government on debt counseling and tracking students for repayment. They are also able to offer incentives such as further reducing interest rates for students who make payments on time or have payments automatically deducted from their bank accounts. A lower default rate could end up saving taxpayers money, he said.

Richard Vedder, an economics professor at Ohio University and director of The Center for College Affordability & Productivity, said he agrees in principle with Romney that private competition is better than a government monopoly. But, he said, “Romney’s idea doesn’t deal with the bigger problem,” such as rising college costs and a school’s failure to properly prepare graduates.

Neal McCluskey, higher education analyst at the Cato Institute, said Romney’s plan does not go far enough. He would like a system run entirely by private companies in which the federal government does not guarantee anyone a profit and does not absorb the risk of default.

What Romney is proposing, “would be an almost meaningless change from a college affordability and consumption standpoint,” he said. “Obviously it would have an effect for banks and lenders, who would be happy to go back to that. It was a great gig for them.”

Other higher education experts say they are wary of returning to a system in which private lenders played the primary role. They cite a 2007 kickback scandal involving nearly two dozen lenders.

Several state attorneys general — most notably Andrew Cuomo, now governor of New York, but also Martha Coakley of Massachusetts — investigated the firms for unscrupulous practices such as providing university financial aid officials with perks or revenue-sharing agreements in exchange for helping to steer loans their way. Cuomo’s investigation resulted in $13 million in settlements with 28 colleges and 22 lenders.

One of the companies he investigated, College Loan Corp., has contributed at least $10,000 to Romney’s campaign. In 2007, Cuomo linked the company, then the nation’s seventh-largest student loan provider, to 28 schools, including two in Massachusetts, whose financial aid officers were given meals, entertainment, and trips for sitting on advisory boards. In addition, the company hosted financial counseling sessions on behalf of schools and misused them as a marketing opportunity. Federal law required that the sessions provide lender-neutral information.

The company ultimately paid a $500,000 settlement to a fund Cuomo established to educate students about their loan options, and it agreed to stop offering such perks.

Asked what Romney would do to curb the abuses by private lenders were they to reenter the market, Hansen said, “Those are very real concerns that need to be addressed in designing a new program, but it’s a small issue compared to the larger issue of student debt.”

For more than four decades the government had backed all federal student loans against default, even when they were issued by private companies.

By cutting out the middlemen and the generous subsidies the government had been paying them, the 2010 move saves more than $60 billion over a decade. More than half the savings were plowed into Pell grants, which students do not have to repay.

Obama has sought to capitalize on his role in moving the system toward direct lending, telling students at the University of North Carolina during his visit to Chapel Hill in April that doing so helped make college more affordable because the government was able to issue more Pell grants.

Delisle, a Republican who supports Romney on most other issues aside from student loans, said Obama deserves credit for reforming a broken system.

“On this issue, Romney is just ridiculous,” said Delisle, who nevertheless says he will most likely vote for Romney. “His campaign staff doesn’t have any new ideas, so they said, ‘Let’s just go back to what we were doing before the Obama administration came into place.’ ”