Student Loan Swindle:

Corrupt Student Loan Industry Cries for Government Intervention

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Alan Collinge (2009), the author of *The Student Loan Scam: The Most Oppressive Debt in U.S. History – and How We Can Fight Back*, never thought that he would be “a crusader for student loan justice” (p. vii). Like many American college students who grew up in middle class families, Collinge had to take a “necessary evil” – a student loan – of $50,000 in order to pay for his bachelor’s degree in aerospace engineering at the University of Southern California (p. vii). His plan was simply to graduate, to find a well-paid job, and to repay his loans. Unfortunately, the author could not manage to succeed in this plan. When he found a job as an aeronautical research scientist at Caltech, he could only cover rent, food, and “basic necessities” (Collinge, 2009, p. vii). As a result, he got behind on his student loan payments, which constituted about 20% of his monthly income. He called his lender, Sallie Mae, and was assured by their representatives that it was not a big problem: they would only charge him a late fee. However, Collinge was charged a late fee every month even though he made his monthly payments on time. At this point, the author realized that Sallie Mae was not “a government entity, but, rather, a for-profit corporation” (p. viii). At that time, Collinge decided to refinance his loan with another lender, but found out that it was illegal because federal regulations permitted the consolidation of student loans only once. So, he quit his job and tried to find another one within the defense industry. Unfortunately, after 9/11, he could not find any job whatsoever and had to apply for “economic-hardship forbearance” (Collinge, 2009, p. viii). Sallie Mae defaulted his loan and notified Alan that they no longer held his loan. By 2005, his loan “had swollen to $103,000” (Collinge, 2009, p. x). After some research, the author found out that Sallie Mae and other private lenders were making much more money from defaulted loans than from regular ones. Between 1995 and 2005, Sallie Mae's stock increased by 1,700% (Collinge, 2009, xi). Moreover, he found that the Department of Education's Office of Student Aid had been managed by "a former student loan company executive" (Collinge, 2009, p. xi). Finally, the most important finding the author made was that "millions of other citizens were trapped as I was" (Collinge, 2009, p. xi).

When college students and their parents apply for loans in order to finance their higher education, they rely on college officials and the government to act on students' best interests; prospective students and their parents rely on a list of private lenders offered by an institution. People do not expect this list to be filled with corrupt private lenders. Unfortunately, this is not often the case, and in 2007, the student loan corruption scandal emerged after an investigation of several college and government officials by New York State Attorney General Andrew Cuomo. As a result, Matteo Fontana, the Office of Federal Student Aid general manager, and three other senior financial aid officers at Columbia University, the University of Texas, and the University of Southern California were found to hold shares in private student loan companies' stocks (Spencer, 2007). Additionally, some schools were found to take kickbacks and "economic incentives" from private lenders for putting these specific lenders on their "preferred lenders list" (Goral, 2007, p. 50).

In this paper, I will discuss the scope of the problem by describing differences between federal and private loans. I will also review the trends of the cost of higher education. Additionally, I will emphasize the reasons why the current loan practices need to be changed. Corruption among the government officials and college management is one of them. It is important for the student loan industry to reduce corruption among college and federal student aid officials and to succeed in creating efficient student loan programs and regulations.

Therefore, corruption in the student loan industry can be sufficiently reduced by increasing the percentage of students enrolled in direct loan programs and making these federal loans more competitive, investigating every claim about allegedly unethical or illegal conduct of college and government officials regarding student loan procedures, and conducting an independent audit of financial disclosure records of government employees involved in student loan programs.

As it stands, the term “affordable education” is not realistic. According to the College Board, in 2008-2009, 55% of public college alumni had an average student loan debt of $20,300, and 65% of private nonprofit college alumni graduated with an average debt of $22,300 (2010). Additionally, student loan debts, both private and federal, total about $829.785 billion and exceed even revolving credit card debt, which constitutes about $826.5 billion (Pilon, 2010). Interestingly, the number of credit card holders significantly exceeds the number of student loan borrowers (Nasser & Norman, 2011). In 2007 – 2008, the National Center for Educational Statistics[1] (NCES) estimated the annual cost of undergraduate tuition and room and board to be $11,578 at public institutions and $29,915 at private institutions (2009). Between 1997 and 2008, the cost of undergraduate tuition and room and board increased by 30% at public institutions and by 23% at private institutions (NCES, 2009). Apparently, undergraduate education has a tendency not only to increase but to increase considerably.

Although the private loan industry managed to satisfy student’s needs for financing higher education in the early 1990s, the system failed because of corrupted government officials, school administration, and loan lenders. In order to evaluate shortcomings of private loan industry and the federal one, we should describe main differences between these two industries. The Direct Loan Program offers several types of Stafford loans, subsidized and unsubsidized, for undergraduate students; PLUS loans for parents and graduate students; and consolidation loans

[1] The data from the National Center of Educational Statistics is adjusted for inflation.

for federal student loans borrowers only (Federal Student Aid [FSA], 2010). Federal student loans are backed by the government and are available directly through the Financial Aid Office of an educational institution or through banks (Student Loan Network, n.d.).

Direct subsidized loans are for students who exhibit financial need; the amount of the loan is determined by reviewing an applicant's Free Application for Federal Student Aid (FAFSA) (FSA, 2010). A student is not charged any interest on this loan while he is attending school at least part-time (FSA, 2010). Any student can apply for Direct Unsubsidized Loans because they are not determined on the basis of financial need; an educational institution determines the size of the loan an applicant qualifies for (FSA, 2010). The interest on this loan accrues from the time of the first payment (FSA, 2010). A student can pay interest while in school; however, if he or she chooses not to pay it as the interest accrues, this will increase the total amount a student has to repay (FSA, 2010).

For Subsidized Loans, undergraduate students have to pay 4.5% in fixed interest if their first payment is due between July 1, 2010 and June 30, 2011; if their first payments fall between July 1, 2011 and June 30, 2012, students have to pay a fixed interest rate of 3.4% (FSA, 2010). In the cases of Graduate Loans and Direct Subsidized Loans, the rates are fixed at 6.8% (FSA, 2010). Most federal student loans are qualified for consolidation; however, private student loans are not eligible for consolidation (FSA, 2010). If a student is in default, he or she has to meet certain requirements in order to be qualified for the federal consolidation programs (FSA, 2010). As other federal loans, the Federal Consolidation Loan has a fixed interest rate that cannot exceed 8.25% (FSA, 2010). Even though federal loans have the lowest rates and the highest flexibility in repayment plans, these loans often do not cover the whole tuition (Student Loan Network, n.d.). As a result, students and their families have to take a loan from a private lender.

Unlike federal loans, private loans usually cover full tuition costs, offer various benefits that can reduce the interest rate, and do not require a student to fill out a FAFSA form (Student Loan Network, n.d.). Nevertheless, the total loan size and the interest rates on private loans are determined by an applicant's credit history; the interest rate is variable and can change over time (Student Loan Network, n.d.). Since financing college education is one of the main concerns of prospective students and their parents and not every student can cover full tuition cost and room and board by taking federal loans, making the student loan industry transparent, free of corruption, and affordable to every potential student in the United States is essential. Therefore, the government should intervene and change currently existing mechanisms of this industry into a new student loan industry that will eventually represent students' best interests.

First, the government should increase the percentage of direct loans and make them more competitive with private companies' loans in order to reduce corruption in the student loan industry and to ease the process of obtaining student financing. By 1997, the direct lending program introduced by President Clinton gained approximately one-third of the student loan market due to its simplicity and decreased lending costs for taxpayers (Beaver, 2008, p. 217). However, in the late 1990's private companies responded by decreasing their interest rates on student loans, later resulting in some colleges switching back to private lenders (Beaver, 2008, p. 217). Private lenders were offering consolidation loans to direct loan borrowers with rebates on fees and interest rates (Burd, 2007). From 2003 – 2005, approximately 800,000 direct loan borrowers refinanced their student loans, totaling $17 billion, with private loan providers (Burd, 2007). At this point, federal student loans could not compete with the private sector. Even though college tuition has risen significantly, federal and state grant aid for low-income students has decreased, and students started taking private loans from colleges' "preferred lender" (Spencer, 2007).

In response to the incapability of federal student loans to compete with private lenders and to the corrupted practices committed by private lenders and college officials, in March 2010, President Barack Obama reconciled student loan reform with Congress. As a result, the number of direct loans will be increased and will be given to private companies only on the best-performance basis controlled and evaluated by the Department of Education; income-based repayment plan recipients will pay no more than 10% of their income above a basic living allowance; and remaining loan debt balances will be forgiven after 20 years for borrowers who always make their monthly payments (The White House, 2010). On the one hand, President Obama's reform makes higher education more affordable and accessible to the majority of the population – an increased number of direct loans simplifies the process of borrowing and reduces the cost of loans. Also, payment limits and loan forgiveness options result in less stress from paying student loans for economically unviable borrowers. On the other hand, the problem of direct loans being competitive compared to private loans still exists. Since private college tuition differs significantly from public college tuition, the amount of a loan granted by the Direct Loan program does not always cover students' expenses in financing private higher education. Therefore, federal and state governments should not only work to increase the number of direct loans offered to students and their families but also should make direct loans sufficient, competitive, and advantageous to prospective borrowers.

Second, corruption in the student loan industry can be reduced by a mandatory investigation of all claims regarding alleged unethical or illegal actions conducted by college or public employees concerning student loan procedures. Since most students and their families rely on a college's "preferred lender" list to choose a loan lender and private loan providers in these lists get 90% of student loan applications, being on "preferred lender" lists is attractive for any private loan provider (Beaver, 2008, p. 218). Consequently, loan lenders are interested in offering colleges incentives in the form of kickbacks and stock shares (Beaver, 2008, p. 218). The Department of Education announced that at more than 900 colleges a single lender held 80% of student loans (Beaver, 2008, p. 218). Interestingly, between 2001 and 2006, the Department of Education received 26 complaints concerning "improper inducements," but investigated only two of them regardless of 1995 legislation banning colleges from accepting any incentives from private loan providers (Beaver, 2008, p. 219). Additionally, Jon Oberg, a former employee of the Institution of Education Sciences within the Department of Education, wrote a memo informing his supervisor that private loan providers had overcharged the government for subsidies on student loans (Goral, 2007). Instead of investigating this matter, Mr. Oberg's supervisor ignored his findings and transferred Oberg to another department to prevent the information from becoming public (Goral, 2007, p. 52). Undoubtedly, the student loan industry exhibits shortcomings that have to be fixed. If all of these claims and incidents were investigated in the first place, private lenders would not have had an opportunity to exercise unethical and illegal economic practices. Therefore, the investigation of all claims concerning student loan corruption should be mandatory.

Third, independent audits of public officials' financial disclosure records will also reduce corruption in the student loan industry. In 2007, the New York State Attorney General's office found that Matteo Fontana, the former general manager of the Office of Federal Student Aid, sold thousands of Student Loan Xpress' shares and collected more than $100,000 (Spencer, 2007). Mr. Fontana was responsible for overseeing a national database containing personal information of student loan borrowers (Glater, 2007). Additionally, Andrew Cuomo's investigation discovered that three other financial aid officers at three major universities held shares in the same loan company (Spencer, 2007). In fact, David Charlow sold 7,500 shares in Student Loan Xpress for $72,000 while holding a position as an aid administrator at Columbia University; Mr. Charlow sold additional shares later and earned more than $100,000 (Spencer, 2007). Interestingly, Mr. Fontana informed the department about his stockholdings and sales by submitting a disclosure form because the value of his stock exceeded the permitted limit of $15,000 (Glater, 2007). According to federal rules, a public employee is allowed to hold stock in any company if he or she is not working on any matters involving this company (Glater, 2007). However, it was still unclear whether the Department of Education reviewed Fontana's disclosure forms and permitted stockholdings in Student Loan Xpress (Glater, 2007). The Department of Education's discretion and professionalism seems very questionable due to this incident. Apparently, Mr. Fonatana's personal holdings in Student Loan Xpress demonstrate a conflict of interest. Unfortunately, the federal government failed to investigate this matter, negatively affecting borrower's trust in federal student loan programs. In order to eliminate the chances of corruption among government officials and gain the trust of prospective student loan borrowers, the government should conduct an independent audit of public officials' disclosure forms, especially if these people are directly involved in federal student loan program's decision-making or administration.

Getting a college degree is one of the steps necessary for young people to enter the economy as a skilled workforce that is qualified for a higher salaries and wages. Often, being hired for a well-paying job means completing at least a four-year degree. However, the constantly increasing cost of higher education and high standards of eligibility for both federal and private student loans create additional obstacles for young people to enroll in colleges and complete Bachelor's degrees. Students carefully consider all the possible options before making their final decisions whether to go to college or not; students and their families are concerned about their ability to pay off student loan debt in the future. Corruption in colleges and public administrations only increases students' concerns about financing their undergraduate degree. As it appears, instead of representing students' best interests, colleges unethically place lenders on "preferred lender" lists based on illegal kickbacks. Moreover, government officials and college administrators have stockholdings in private student loan companies, and the senior management does not review their employees' disclosure records properly. The existing student loan industry cries for government intervention. Therefore, by increasing government involvement in the student loan system and insisting on the mandatory policing of both private loan lenders and public officials, the federal government will eventually reduce unethical and illegal actions in the student loan industry and will contribute to the greater accessibility of higher education.

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