



Credit Crisis and the Impact on FFELP

Recent steps by Congress, the U.S. Education and Treasury Departments and the Federal Reserve to increase the funding available to lenders to make federally guaranteed student loans are the culmination of developments that date back to 2007.

Late 2007 / Credit Market Turmoil Begins

“The subprime mortgage credit crisis, when combined with the lender subsidy cuts from the College Cost Reduction and Access Act of 2007, has presented significant challenges to the nation’s education lenders.”

Mark Kantrowitz, publisher of finaid.org

Near the end of 2007, disruption in the broader capital markets – which first erupted in the subprime mortgage market – began to affect the capital markets that serve lenders that make student loans. In short, it impaired their ability to raise the capital needed to fund federally guaranteed student loans. More specifically, investors (e.g., pensions, mutual funds, endowments etc.) stopped purchasing financial instruments long used by lenders, museums, universities and others to raise capital cheaply and efficiently: asset-backed securities, including auction rate securities. This happened even when the underlying assets were student loans guaranteed by the full faith and credit of the United States government, such was the level of fear and irrationality driving credit market decisions.

The net results were that many lenders that participate in the Federal Family Education Loan Program (FFELP) found it impossible to raise capital and, for others, capital became much more expensive. The financing cost for AAA-rated student loan-backed securities, where the underlying loans are government guaranteed, increased by more than 125 basis points (1.25 percent).

The interaction of the collapse of traditional and long-standing methods to fund student loans, *combined with the financial impact of the 2007 congressional budget cuts*, resulted in more than 100 lenders suspending or terminating their participation in FFELP.

May 2008 / Emergency Law Passed

In response, Congress passed, with bipartisan support, and the President signed the *Ensuring Continued Access to Student Loans Act* (ECASLA) of 2008. It provides the Department of Education – *at no cost to taxpayers* – the authority to provide liquidity, or funding, to FFELP lenders. (The law also includes beneficial provisions for students and families, including permanently increasing annual unsubsidized Stafford loan limits and increasing flexibility for PLUS

Loan borrowers.) The law assures borrowers that federal student loans will continue to be readily available for the 2008-09 academic year.

September 2008 / ECASLA Extended at No-Cost to Taxpayers

Congress passed bipartisan legislation in September extending ECASLA for an additional year. Families had begun making college plans and decisions for the 2009-10 academic year, and Congress was concerned that the credit markets continued to present tremendous challenges to the ability of many lenders to attract affordable sources of capital. The extension assures schools, students and parents of the availability of federal student loans through 2010.

November 2008 / Additional Measures Announced

The Education and Treasury Departments announced new steps to implement the ECASLA and assure funding for federal student loans. One of these steps includes finalization of the ECASLA Programs for 2009-10. The successful programs that support FFELP originations for the current school year will be extended to cover the 2009-10 academic year, thus assuring that student and parent borrowers will continue to *have uninterrupted access to federal student loans for 2009-10*.

The Department of Education also announced that it will fully implement the ECASLA by helping lenders finance existing loans through the private capital markets. This longer-term support for outstanding loans will also add “no net costs to the Federal Government.”

In Summary

The Congress and Department of Education’s quick and decisive steps to address liquidity problems facing student loan providers have successfully and cost-effectively averted a crisis in federal student loans. Families have been able to make college plans and decisions on the basis of what’s best for their children. Moreover, students, parents and schools continue to enjoy the high level of service and effective default prevention programs offered by lenders and guaranty agencies that participate in FFELP.

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Tuition Ammunition: a Happy Lesson on Lending The U.S. Government's Effort to Save Student Loans Has Been One Bright Spot in a Season of Crises and Bailouts

By **ROBERT TOMSHO**

Despite a massive federal effort to aid banks and boost the economy, lending has plunged in the last year. Home-mortgage volume and bank loans to big companies are down dramatically.

But the government's response is expanding credit in at least one sector: higher education. Although the recession is weighing on colleges in many ways, the ability of students to get federal loans to pay tuition isn't one of them.

As of Nov. 28, the federal government had guaranteed or made \$65.2 billion in student loans for the 2008-09 school year, up 18.6% from the same time a year earlier. In contrast, lending for home mortgages was down nearly 38% through the end of November, according to Inside Mortgage Finance, a trade publication. A recent Harvard Business School study found a similar decline in loans to big corporations.

With some schools considering tuition increases and private student loans becoming scarce, many students and families will still face borrowing challenges.

For the moment, however, student-lending boosts are working well, experts and lenders say, because Congress and the Bush administration intervened quickly. Legislation in the spring ensured that government capital would be committed only if new loans were made. In the broader rescue effort outside the education sector, the Treasury provided tens of billions of dollars to banks without requiring any increase in lending, which has become a focal point of criticism.

Under the Ensuring Continued Access to Student Loans Act, parents can defer repayment of federal loans they take out until after their child is out of school. Annual borrowing limits for unsubsidized Stafford loans -- federal loans for which students don't have to prove financial need -- were increased by \$2,000, bringing the cap to as high as \$7,500 a year for juniors and seniors.

Like auto manufacturers and investment firms, some student lenders sought upfront infusions of federal funds. But under the Student Loan Act -- signed into law just a month after it was introduced in Congress -- the government required lenders to make loans with their own funds before the federal government would buy or invest in them.

"We thought that was one of the ways to do it to make sure they were, in fact, players in the game," said U.S. Rep. George Miller, the California Democrat who is chairman of the House Committee on Education and Labor.

Some observers say the effort could help guide intervention efforts elsewhere in the economy. If federal officials had responded as well as they did with student loans, "we might not be in as bad a pickle as we are," said Philip Day, president of the National Association of Student Financial Aid Administrators.

U.S. Education Secretary Margaret Spellings said she is not ready to "declare any victories," but "what we have seen so far is that the programs we have put in place are having the desired effect."

"So far, our students have not had any lack of loan access," said Patricia McGuire, president of Trinity Washington University, who told the Senate banking committee in April that she was concerned about the availability of credit.

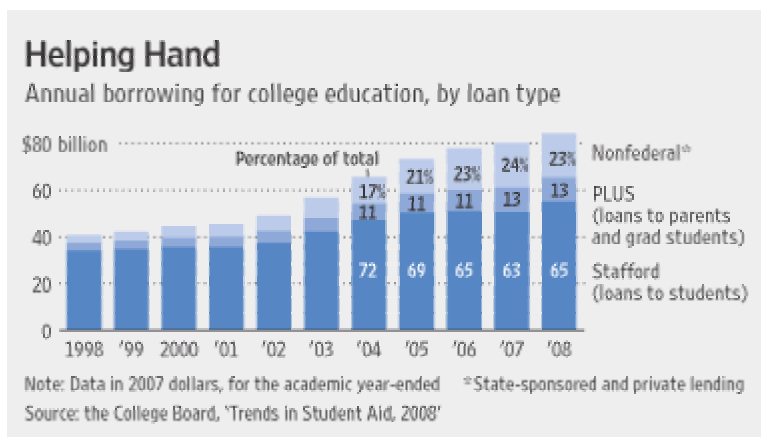
The student-loan market is a fraction of the size of those for mortgages and commercial loans, and troubles in home lending have been complicated by defaults on existing loans, not a major issue with college lending.

For the time being, the stability granted by the broadened loan access has provided some significant measure of relief in light of other economic woes pressing higher education. Job losses are making it tougher for parents to write tuition

checks. Some budget-strapped schools are pursuing enrollment caps and double-digit tuition increases as they face declines in endowment earnings and state support.

"We still feel like more money needs to go into financial aid," said Carmen Berkley, president of the U.S. Student Association, a Washington advocacy group that is lobbying Congress to let students borrow more money under federal programs.

The stability of federal loans has benefited college student Ashlin Ware. With both parents deceased and no one to co-sign for her on a private loan, Ms. Ware said she couldn't consider a more expensive school than the University of Wisconsin. A junior, she has relied on part-time work and various forms of financial aid -- including federal loans -- to pay her way. "If I don't have my



federal loans or the loans from school, there is no way for me to go to school," she said.

The availability of private credit, however, continues to be an issue. Private loans accounted for about \$17.6 billion, or one-fifth of the \$85.9 billion in total lending, in the 2007-08 academic year, according to the College Board. Although such loans frequently come with higher interest rates than federal loans, they have become a major source of financial aid in the past decade as tuition increases have outpaced gains in family income and federal student-aid limits.

Amid the credit crunch, 39 lenders have stopped making private student loans; others have tightened lending standards. Lenders and analysts estimate that private student lending has fallen as much as 25% this school year, as the market for selling bundles of these loans as securities to investors has dried up.

The decline is likely to prompt more students to pursue less expensive options. "The cloud of this financing issue will push more of them to state public universities and community colleges," said Tim Ranzetta, president of Student Lending Analytics, a research concern in Palo Alto, Calif.

Ben Kittner, of Raleigh, N.C., said the cost and availability of federal loans are major reasons his daughter, Kaylie, a high-school senior, is applying to three state schools and only one private one. "Definitely, it will come into consideration when we know where she is accepted," said Mr. Kittner, a market-research manager for a nonprofit.

To help jump-start private lending, the Federal Reserve announced in November a \$200 billion program to encourage investors to buy securities backed by private student loans and other consumer debt. Observers say changes on the federal side are likely to lessen the demand for private loans.

The mainstay sources of credit -- loans guaranteed or made by the federal government -- are expanding. During the 2008-09 academic year, guaranteed loans made under the Federal Family Education Loan Program have risen 9.4% to \$46.7 billion, despite the fact that 106 lenders have pulled out of the program. Hundreds of schools have switched to the program in which the government lends directly to students. Loan volume in that program is up 50.4% to \$18.5 billion.

Hit by subsidy cuts in 2007, FFELP lenders last year saw their profits erode even further as the credit crunch caused them to offer investors higher interest rates to sell loan-backed securities, a major source of lending capital. By April, more than 30 lenders had stopped making FFELP loans and SLM Corp., the big student lender known as Sallie Mae, was warning it might do so as well.

But the Student Loan Act empowered the Department of Education, with support of the U.S. Treasury, to buy new FFELP loans directly from lenders, paying them the full principal value, plus accrued interest and a \$75 fee. The government also agreed to invest in trusts containing new FFELP loans and, in return for certain payments, reimburse lenders for the full cost of the loans. Lenders would have to use any federal money they received to make new loans.

"This program was implemented in what I would call record time," said Jack Remondi, chief financial officer of Sallie Mae, which plans to make \$20 billion of FFELP loans this school year.

Federal officials say the government has directly purchased about \$97 million of loans and invested about \$10 billion in the trusts. Both figures are expected to grow before the end of the school year.

Although the law originally was set to expire after 2008-09, Congress extended it for another school year to reassure students and families as they made plans for 2009-10. Meanwhile, the Department of Education recently announced a plan under which it will act as the buyer of last resort for certain securities backed by loans made as far back as Oct. 1, 2003.

Terry Hartle, senior vice president of the American Council on Education, a trade group representing educational institutions, cautioned that credit conditions have eroded significantly since the law was hashed out in the spring, and that there is no telling how lenders will respond as the crisis drags on. But for the moment, he added, "this is one piece of legislation that worked exactly as the play was drawn up on the blackboard."