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For Sallie Mae, the Student Debt Crisis Is Enormously Profitable

By KATHLEEN CULLITON MAY 31, 2012 4:15 PM

While American Millennials stagger under the weight of student debt, SLM Corporation, or Sallie Mae, reaps the benefits.

MINYANVILLE ORIGINAL A seventeen-year-old cannot vote. She or he cannot apply for a credit card under her own credit. She or he cannot buy alcohol, cigarettes, or pornography. She or he cannot rent a car or a hotel room. So why is it so easy for a seventeen-year-old to rack up $23,000 in debt?

That's how much the average graduate will have in student loan debt on the day she or he leaves college.

Of the 1,781,000 students that the National Center for Education Statistics says will graduate from college this year, 66% will leave with student loans averaging $23,200, according to The Project on Student Debt. This translates to 1,187,334 students graduating holding approximately $27 billion in debt in 2012 alone.

Of that group, approximately 340,000 (9.3%) won't find employment and 600,000 (33%) will take jobs that, ironically, do not require college degrees. It's all but guaranteed that the first group will default on their loans and more than likely that the second group will as well -- at least those who have not found themselves in one of the rare high-paying non-degree (but usually license-based) fields, which include jobs like air traffic controllers, commercial pilots, and landscape architects.

And those are the 2012 graduates. A further 1,343,561 students who matriculated in 2008 failed to graduate and are holding an unknown amount of student loans. Assuming that 60% of that group had loans averaging a hypothetical $10,000 each, that's another $8 billion in debt.

How did this happen?

Its origins can be found in fear, the federal government, and the best of intentions.

On October 4, 1957, a couple of students working at a ham radio station at Columbia University recorded a monotone beep, picked up by their receivers. When they played the sound on FM radio, it would be the first time Sputnik was broadcast for the American public. It was the evidence that Russians had beaten the US in the space race; it shamed and frightened many.

Less than one year later on September 2, 1958, Congress passed the National Defense Education Act to promote higher education in the sciences, mathematics, and foreign language. The act gave the Department of Education the authority to subsidize student loans for higher education.

In 1972, the Student Loan Marketing Association, otherwise known as SLMA (or Sallie Mae) became the government sponsored-enterprise authorized to work in conjunction with the Department of Education in allocating loans to students. Sallie Mae's position steadily strengthened from that point.

Catherine Austin Fitts, a former member of the Sallie Mae board in 1991, recounts in her startling article on Solari.com how the management began hedging their positions with interest rate swaps in the derivatives market, a "risk free" investment that ballooned their balance sheet without any benefit to students.

According to Fitt's calculations, Sallie Mae's "arbitrage of the federal credit...resulted in the transfer of trillions in wealth from the general economy to the large banks...that enjoy government sponsored-enterprise status." She left Sallie Mae when directed to find new ways to increase revenue further.

In the years that followed, the Sallie Mae board of directors, headed by CEO Al Lord, took two definitive steps towards the goal Fitts found so unnerving: They lobbied to reform the bankruptcy and debt collection regulations to make student loans virtually inescapable, and they fought to privatize Sallie Mae. They were successful on both counts.

In 1991, the Higher Education Technical Amendment eliminated the statute of limitations on federal education loans, allowing the company to pursue every unpaid debt since 1972. That year, Congress also passed an amendment to the Higher Education Act of 1965 allowing for the company to claim up to 10% of disposable pay of defaulted borrowers, which was further increased to 15% in 2006.

The laws were adjusted to follow students even into their retirement years. In 1996, the Debt Collection Improvement Act was expanded to allow the SLMA to claim 10% of Social Security benefit payments to repay defaulted federal education loans. That amount was raised to 15% in 2001.

By 2004, which was the year that Sallie Mae completed Al Lord's goal of privatization and officially became **SLM Corporation** (SLM), the *Wall Street Journal* reported that for every dollar paid out in default claims, not only would a full dollar would be recovered but an additional 20% in interest and supplementals would be charged. To put this number in perspective, this is roughly the same interest that credit cards earn on their debts.

How many students end up defaulting on their loans is a question in deep contention. While the Department of Education reported for years that only 5% of student loans are defaulted on, further studies from the Office of the Inspector General place the number between 19% and 31% for four-year universities and between 38% and 51% for for-profit schools.

So, how much is this enriching Sallie Mae? If you figure the higher number is correct and 31% of this year's university graduates default on their loans, that puts SLM Corporation's profits at around $7.7 billion (factoring an average loan of $23,000 times the legal profit margin of 1.2%). An additional $4.9 billion comes directly from the federal government to guarantee loans. But even this only represents SLM's legally gotten profits.

In 2003, a researcher for the Department of Education discovered that a loophole in the law had resulted in the federal government over-paying at least $1 billion in student loan subsidies. When Jon Oberg told the department of his discovery, he was asked to work on something else, which he did until 2007. In January of that year, he filed suit against several of the loan companies; primary among them was SLM Corporation.

Sallie Mae also worked with colleges and universities across the nation to increase the number of students taking out loans. In 2007, New York Attorney General Andrew Cuomo announced a nationwide investigation into a kickback scheme involving 100 colleges and private student loan providers.

It turns out that SLM, along with **Nelnet** (NNI) and the **CIT Group** (CIT), provided sponsorships and multi-million dollar lines of credit directly to the universities, paying hundreds of thousands of dollars in "bonuses" directly to to financial aid officers who would put them on a list of "preferred" lenders given to students.

Cuomo charged that approximately 90% of students chose their lenders from their school's preferred lender lists, and that the students were never made aware of the corporation's dealings with the schools.

SLM Corporation paid $2 million in reparations to put the investigation to rest in April 2007. By March 2012, according to the Consumer Financial Protection Bureau, student debt surpassed $1 trillion.

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No positions in stocks mentioned.