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Deals Between Private Lenders and Colleges Raise Concerns.Stephen Burd. ***The Chronicle of Higher Education*** 53.5 (Sept 22, 2006)(1091 words) From *General Reference Center Gold*.

Full Text:

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A growing number of institutions -- particularly high-priced private colleges, some public flagship universities, and for-profit institutions -- are including private loans in the financial-aid packages they offer to students.

Colleges can "package" the loans to needy students because of special deals their institutions have struck with loan providers. In exchange for steering prospective borrowers their way, lenders allow colleges to provide their private-loan products to students who otherwise would not be able to obtain them because of past credit problems.

College officials who have entered such arrangements say they are simply trying to get the best deals for their students. But critics, some of whom are in the loan industry, say the practices are putting needy students in harm's way.

Perhaps the most controversial of the deals is the "opportunity pool." Such arrangements, the legality of which is questioned by many student-aid experts and even some loan-industry officials, allow lenders to leverage private loans to get a larger share of the federal student-loan business.

Under this type of deal -- pioneered by Sallie Mae, the nation's largest student-loan provider -- a lender gives a college a fixed amount of private loan money that the institution can provide to students who otherwise would be ineligible for the loans. In return the institution agrees to make the loan provider "a preferred lender" of federal loans on its campus.

While federal student-loan law prohibits colleges from requiring students to borrow from a specific bank, many institutions suggest "preferred lenders," and those are the ones that students usually choose. As a result, lenders compete vigorously to be put on a college's preferred list.

Soon after Sallie Mae started offering its Opportunity Loan Program, in 2000, competitors and critics began raising questions about whether it violated a provision of the Higher Education Act barring lenders from offering inducements to colleges "to secure applicants" for federal loans.

Sallie Mae officials say the program is beneficial to students who might not otherwise have been able to afford to stay in college.

After conducting a preliminary investigation in 2003, the U.S. Education Department's inspector general at the time, Cathy H. Lewis, wrote a memo urging agency officials to take a closer look at opportunity-pool deals.

"There are bargaining processes between schools and lenders for preferred-lender status and private-loan volume that should be addressed through statutory and regulatory changes or further department guidance," she wrote.

Department officials took no action, saying they preferred to let the loan industry police itself.

Many lenders saw the department's decision as a tacit approval of the arrangements. "The department's refusal to call an opportunity pool an inducement put pressure on others to form the same kind of deals," says a private-loan provider who wished not to be identified for fear of offending his colleagues. "Now there are a number of companies doing it. It's a lot more prevalent."

Student-aid experts say that for lenders, the deals are "loss leaders," meaning that the companies are willing to risk having a certain number of loans go into default in order to expand their presence on a campus.

But the experts worry that the arrangements put needy students at risk. Colleges can make the deals only because they have "the luxury of not having to think about the amount of effort students will face repaying the loans," says Brian Zucker, president of Human Capital Research, an Illinois-based higher-education consulting firm.

Sharing the Wealth

Companies that provide private loans exclusively must find other ways to compete.

Some, like MyRichUncle, a New York-based lender that until recently didn't participate in federal programs, market private loans to borrowers directly rather than through financial-aid offices.

But others have developed their own types of deals to appeal to colleges.

Education Finance Partners, in San Francisco, which entered the business in 2003, has found an unorthodox way to get a foothold in the market: offering colleges a share of the revenue the company makes on each loan taken out by their students.

Tamera Briones, chief executive officer, acknowledges that her company has a "competitive advantage" over federal student-loan providers, which are prohibited from entering into such arrangements. "The fact that we don't participate in the federal loan programs frees us up from the federal regulations," she says.

At least one competitor is, in fact, raising questions. In a major advertising campaign this summer, MyRichUncle took aim at college financial-aid offices that take part in such deals.

"Revenue sharing is also known as 'kickbacks,'" said the ad, which ran in The New York Times, USA Today, and The Wall Street Journal.

Such arrangements are particularly problematic, officials at MyRichUncle argue, because they might entice colleges to use a lender even if it does not offer the best loan terms available.

Ms. Briones bristles at such criticism. "Our loans are fairly priced," she says. "We offer one of the lowest rates out there."

Besides, she says, colleges generally use the money they earn on the loans to provide more financial aid. Such is the case at Salve Regina University, in Rhode Island. Aida Mirante, financial-aid director there, says her institution uses that revenue to finance need-based scholarships.

But other higher-education officials are uncomfortable with such revenue-sharing arrangements. "I would personally discourage it," says Dallas Martin, president of the National Association of Student Financial Aid Administrators. The deals, he says, "create an appearance in many cases of a conflict of interest."

Taking on Risk

First Marblehead, one of the largest private-loan providers in the country, offers a different kind of deal.

Instead of sharing revenue, the Boston-based company asks colleges to share the risk of lending money. They must "cover default costs up to a limited amount" on loans that First Marblehead provides to "students who would not ordinarily qualify," the company says in its marketing materials.

Under the GATE Student Loan Program, one of the company's signature products, the more liability a college is willing to take on, the better terms its students will receive.

In its promotional material, First Marblehead emphasizes that the program enables colleges to include the loans in the aid packages they offer students. "You want to attract prospective students with compelling financial-aid packages -- and retain your current students by meeting their ongoing financial needs," says the company's brochure.

First Marblehead says colleges can specify the loan terms they want. The company will "approve students without FICO scores or credit histories, and incoming freshmen can get a loan without a cosigner," says David McLaughlin, the GATE program's national sales director. "That's pretty unique in the industry."

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