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Banks Don't Belong in the Student Loan Business

They get billions in federal subsidies that can provide financial aid to needy students.

By ARNE DUNCAN

Since I arrived in Washington, I've been looking at every line item in the budget of the U.S. Department of Education with two questions in mind: Is this program helping students learn? And is it a good use of taxpayer money? In the case of the Federal Family Education Loan (FFEL) program, the answer to both questions is no.

Under the current FFEL program, banks make loans to students. While those students remain in school, the federal government pays the interest on their loans; otherwise the interest accrues. Once the borrowers leave school or graduate the lending agency collects on the loans. But if the student defaults, my department pays back the loan—plus the interest owed. The FFEL program, in short, is a great deal for bankers but a terrible one for taxpayers.

Over the next decade, according to the Congressional Budget Office, the Education Department is slated to subsidize banks to the tune of \$87 billion to enable them to make federal student loans. All of this money would be put to better use providing financial aid directly to millions of needy students who want a college education. The Education Department will be able to accommodate the new loans through an existing federal public-private partnership. Through that partnership, the federal government makes loans directly to students and uses companies that will provide better service to borrowers at a lower cost to taxpayers.

Critics contend that the government is trying to nationalize a private industry and do away with competition. Our real aim is to simply stop using banks as the middle man for student loans.

The banking industry would continue to compete in the marketplace to finance mortgages, business start-ups, and other forms of credit. But we are intent on stopping subsidies to bankers who make student loans at no risk because they know the federal government will bail them out in case of default.

By working with private sector companies with expertise in the field, we are prepared to initiate all new student loans in the existing federal Direct Loan program. Right now, the Education Department already owns and services 80% of the student loans made last year. It owns such a high volume of loans chiefly because it had to take emergency action in 2008 to ensure students had access to loans when lending in the nation's credit markets was frozen.

Our experience handling the bulk of student loans makes me confident in our capability. This year alone, an additional 500 colleges and universities joined the Direct Loan program. Just last month, the department's independent inspector general's office issued a report documenting that the Education Department had taken the right management steps so that all loans can be serviced by the Direct Loan program.

In a recent survey by the National Association of Student Financial Aid Administrators, schools that have made the switch to direct lending overwhelmingly reported the conversion was easy and quick. That is just one reason why that

association of financial aid experts, along with organizations representing the nation's largest public and private universities, community colleges and college students, support the department's Direct Loan proposal.

The private sector would continue to play an important role in servicing loans. Last summer, the department's Federal Student Aid Office awarded contracts to four companies to service federal student loans, following an intense competition among the best companies in the loan servicing business. These companies are paid more when borrowers are in good standing, and those that keep defaults down and provide the best customer service will be given the most work.

We are preparing to make the switch to direct loans as easy as possible for colleges and universities. We appreciate their feedback, and their ideas will help us transition smoothly from FFEL to direct loans once Congress has passed a bill authorizing the switch to 100% direct loans

As for the \$87 billion we'll save from ending the troubled FFEL program, the administration seeks to use that money for important programs that will improve our economic future. We propose to substantially increase scholarships in the Pell Grant program and other financial aid for low-income students. We would start new programs to raise college graduation rates and strengthen our community colleges. We will expand our investment in early childhood education. Plus, \$10 billion would be set aside to reduce the deficit.

Now is the time to allocate resources to students—not to banks—so they have access to college and other educational opportunities. We cannot in good conscience let \$87 billion in subsidies go to banks when our students desperately need financial help to realize the dream of getting a college education.

Mr. Duncan is the U.S. secretary of education.

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