The New York Times
nytimes.com

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June 10, 2007

Private Loans Deepen a Crisis in Student Debt

By DIANA JEAN SCHEMO

WASHINGTON — As the first in her immigrant family to attend college, Lucia DiPoi said she had few clues about financing her college education. So when financial aid and low-interest government loans did not stretch far enough, Ms. DiPoi applied for $49,000 in private loans, too. “How bad could it be?” she recalls thinking.

When Ms. DiPoi graduated from Tufts University in Boston, she found out. With interest, her private loans had reached $65,000 and she owed an additional $19,000 in federal loans. Her monthly tab is $900, with interest rates topping 13 percent on the private loans.

Ms. DiPoi, now 24, quickly gave up her dream to work in an overseas refugee camp. The pay, she said, “would have been enough for me but not for Sallie Mae,” her lender.

The regulations that the federal Education Department proposed this month to crack down on payments by lenders to universities and their officials were designed to end conflicts of interest that could point students to particular lenders.

But they do nothing to address a problem that many education officials say may have greater consequences — more students relying on private loans, which are so unregulated that Attorney General Andrew M. Cuomo of New York recently called them the Wild West of lending.

As college tuition has soared past the stagnant limits on federal aid, private loans have become the fastest-growing sector of the student finance market, more than tripling over five years to $17.3 billion in the 2005-06 school year, according to the College Board.

Unlike federal loans, whose interest rates are capped by law — now at 6.8 percent — these loans carry variable rates that can reach 20 percent, like credit cards. Mr. Cuomo and Congress are now investigating how lenders set those rates.

And while federal loans come with safeguards against students’ overextending themselves, private loans have no such limits. Students are piling up debts as high as $100,000.

Banks and lenders face negligible risk from allowing students to take out large sums. In the federal overhaul of the bankruptcy law in 2005, lenders won a provision that makes it virtually impossible to discharge private student loans in bankruptcy. Previously such provisions had only applied to federal loans, as a way to protect the taxpayer against defaulting by students.

While federal loans also allow borrowers myriad chances to reduce or defer payments for hardship, private loans typically do not. And many private loan agreements make it impossible for students to reduce the principal by paying extra each month unless they are paying off the entire loan. Officials say they are troubled by the amount of debt that loan companies and colleges are encouraging students to take on.

“It’s a huge problem,” said Barmak Nassirian, associate executive director of the American Association of Collegiate Registrars and Admissions Officers. “When a student signs the paper for these loans, they are basically signing an indenture,” Mr. Nassirian said. “We’re indebting these kids for life.”

Dozens of students interviewed said that when they signed for their loans they were unclear on what interest rate they were getting and that financial aid counselors discussing repayment failed to include interest that students were compounding while in college. The lenders say they are providing a valuable service, helping students who might otherwise not be able to afford college. Tom Joyce, a spokesman for Sallie Mae, the nation’s largest student lender, said the company’s average interest rate on private student loans was just over 10 percent and that the typical

borrower was a young person with little or no credit history and no collateral.

"What would the credit card interest rate be for that borrower — 24, 25 percent?" Mr. Joyce asked. "Our goal is to make it possible for students to graduate."

But various members of Congress are now looking at ways to tighten oversight of private student loans.

The large growth in private loans — once confined primarily to graduate students — largely comes from steep increases in tuition, which have outpaced inflation and federal aid, and an increasing reluctance among parents to take on more debt.

For the last 15 years, the limits on the most common federal loans have stagnated at $17,125 for four years. They will increase slightly starting next month. In addition, loan companies have also come to realize that such loans can be hugely profitable.

Although the federal Education Department has no jurisdiction over private student loans, Education Secretary Margaret Spellings recently pledged to convene the agencies that do, including the Securities and Exchange Commission, the Federal Trade Commission and the Federal Deposit Insurance Corporation.

Research by the U.S. Public Interest Research Group and others show that some students are taking private loans before exhausting their eligibility for low-interest, fixed-rate federal loans.

Janea Morgan, 25, a 2006 graduate of California College San Diego, said that college officials had her fill out the federal financial aid form but never tapped federal loans. Instead, she said, they steered her to a private loan with KeyBank, at an interest rate that could rise four times a year, with no cap.

Now, she is carrying $46,000 in private loans at 9.22 percent interest, which she fears may rise beyond her ability to pay. Ms. Morgan said that when she asked college officials why they bypassed federal loans, "They said it would take too long."

Barbara Thomas, vice president and chief operating officer at California College San Diego, said that she could not discuss Ms. Morgan's situation because of privacy laws, but that generally students sometimes took too long to fill out the federal financial aid application properly. "It's a time thing that kids have to work with," Ms. Thomas said.

Sometimes marketing is at work. Last September, the United States Student Association complained to the Federal Trade Commission that a major private lending program, Loan to Learn, made "false and deceptive claims" in a brochure called "Demystifying Financial Aid."

According to the complaint, the brochure stated inaccurately that "most government loans are need-based," suggested that federal loans could not be used for education-related costs like computers and books, and that there were "strict deadlines" on applying for federal loans. In fact, students can get federal loans to pay for educational expenses, even retroactively.

George C. Pappas, a spokesman for Loan to Learn, dismissed the complaint as "absolutely ridiculous." Nevertheless, EduCap, the parent company, has removed the passages from the guide. The F.T.C. declined to comment on Loan to Learn.

Students with private loans can be caught by surprise at how adjustable interest rates allow debt to swell.

Sean Craig Hicks, 35, attended the Westwood College of Aviation Technology, now known as Redstone College, in Broomfield, Colo., from 1997-2000 in the hope of becoming an airplane mechanic. He said a financial aid officer gave him an application for a $6,000 private loan through Wells Fargo to help pay outstanding expenses just before graduation. On the school's hall walls, he said, were fliers for Wells Fargo loans. "You trust those people when they tell you this is the one to go with," Mr. Hicks said.

Mr. Hicks said his loan documents had promised that if he paid the minimum due each month, he would pay off the loan by 2010. Instead, after six years of payments, most of them on time, he owes $100 more than when he took out the loan.

A spokeswoman for Wells Fargo, Mary Berg, confirmed that Mr. Hicks held a student loan, but called the dealings with him a private matter. Officials at Redstone College did not respond to requests for comment.

Many students out of dozens interviewed said it was not particularly clear what interest rate they had signed up for.

Take Attila Valyi, a Motorola employee in Plantation, Fla. Eager to jump-start his education, he turned to American InterContinental University, a for-profit institution offering a bachelor's degree in 13 months. But discovering how much the diploma would cost was an endeavor worthy of a dissertation.

While the $28,000 tuition was no secret, Mr. Valyi said that at the urging of university officials, he had signed an application for a loan that doubled as a pledge to pay the money back. It did not indicate an interest rate. He took out two more loans before getting his bachelor's degree, realizing only when it was too late, he said, that he carried loans at three different interest rates that could rise from month to month, the largest for $10,745 at 18 percent.

When Mr. Valyi, 30, contacted the lender, Sallie Mae, to refinance, he said he was told he could not do so until he graduated. "You're locked in at 18 percent," he said he was told.

Martha Holler, a spokeswoman for Sallie Mae, said Mr. Valyi and other borrowers of those years would have been told, during the application process and in an approval letter, the interest rate as a percentage above the prime rate. And they were free to cancel, up to 30 days after the money went to the school.

Lynne Baker, a spokeswoman for the Career Education Corporation, which owns American InterContinental and scores of other for-profit colleges, said that the corporation did not track individual student interest rates and that whether to pay such rates was the students' decision.

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