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College financial aid system facing stiff test

By DAVE CARPENTER

The Associated Press

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CHICAGO -- Finding financial aid for college this year promises to be tougher than any final exam. The quest for money that begins for students and parents every January has taken on new urgency in 2009 amid fears that loans and grants will be scarcer than in the past due to the recession.

"The financing system for college is in real crisis," said Barmak Nassirian, associate executive director of the American Association of College Registrars and Admissions Officers. "Every one of the participants in the system is experiencing hardship _ higher education institutions, states, aid donors and families all are cash-strapped."

Federal student loans remain readily available _ with some funding even increased recently by Congress. But the prospect that grants and scholarships may be cut at many schools, combined with the shrinking availability of private loans, has fueled widespread angst at a time when more people than ever are seeking help. Applications for federal aid for the current academic year already are running 10 percent above last year's record pace, according to the Department of Education.

Savings held in Section 529 plans _ the state-sponsored investment funds for college that are popular for their tax breaks _ have been depleted by the worst bear market in decades and home equity values have plummeted. That has sapped two sources most tapped by parents to fund their children's higher education. Colleges' endowments have been similarly walloped.

Private student loans are especially hard hit. Last year, 60 private lenders provided \$19 billion to students. Now, 39 of those have stopped lending to students and the remaining firms have made it harder to borrow, according to Finaid.org, a Web site that tracks the industry.

"The stress level is high," said Rod Bugarin, financial aid adviser for the New York-based college consulting firm IvyWise.

Numerous revenue-short states are likely to consider cutting aid in one way or another, and public colleges and universities are expected to raise tuition _ in some cases by double digit percentages _ as they set rates for next year.

Scholarships from civic groups and local companies across the country also are likely to decline, Bugarin said, although it's too early to know the extent.

What it all means is that families and college counselors are having to hold difficult conversations about reduced savings and the need to take on more debt and lower sights to focus on more affordable schools.

"There are no sure answers because we're in new territory," said Bruce Hammond, a Washington, D.C.-based college admissions consultant and co-author of "The Fiske Guide to Getting into the Right College." "But students with high need and lesser credentials are going to have to brace themselves

for less aid."

Jean Kliphuis, 46, of Huntington, N.Y., is concerned about the tightening vise of college costs and how to pay for them as she studies aid prospects for daughter Katie, a high school senior who has applied to six schools. Jean is a librarian and her husband Tim is self-employed in the office equipment business. As middle-income parents of three children, their tab for college could be overwhelming if they didn't do all their homework on aid options.

"There is money out there, but you have to jump through a lot of hoops to get it," Kliphuis said. "So my husband and I are jumping through the hoops."

The key to success in the "convoluted" financial aid process is good information, she said, and there's lots of it available through schools' aid offices and online at such sites as Collegeboard.com and Princetonreview.com.

Indeed, the news isn't all bad. The federal government has authorized some \$95 billion in grants, loans and work-study assistance to help almost 11 million students and their families pay for college this year, and its recent commitments mean that total will all but certainly be exceeded next year.

"It's scary, but not as scary as people might think," said Lauren Asher of the California-based Institute for College Access and Success, an independent nonprofit group.

Among the encouraging developments for parents and students:

- _ The government broadened student borrowing in the midst of the credit crunch, ensuring the continued flow of federal loans that families depend on ahead of costlier private ones. Among other changes, annual borrowing limits for unsubsidized Stafford loans, which students can take out regardless of income, were raised by \$2,000 and parents can now defer repayment of federal loans until after their child leaves school.

Stimulus proposals that would give students more financial aid also are progressing through Congress.

"This certainly has been an unprecedented disruption in the student loan marketplace," said Mark Kantrowitz, publisher of Finaid.org. "But Congress and the Department of Education have acted quickly to avert a crisis."

- _ No school is known to have withdrawn pledged financial aid this academic year despite financial setbacks that have prompted them to make cuts elsewhere. A number of top institutions, from Harvard, Yale and Duke to smaller institutions with large endowments, announced expanded aid last year and have insisted they will stick to those commitments.

Aid can make a huge difference in affordability. The average list price of tuition and fees for the current academic year is \$6,585 for in-state students at four-year public universities and \$25,143 at private colleges, with some costing far more. But grants and tax breaks lower the average net price to about \$2,900 at public universities and \$14,900 at private schools, according to the College Board.

- _ Some students will benefit from the turmoil, especially at colleges with high tuitions and scarce resources.

"These places continue to jack it up," Hammond said of tuition increases, "so if you can pay the full

outrageous fee in this economy, as long as you can walk and chew gum you will be admitted. And if you're pretty good _ average, even _ you might get a \$10,000 merit scholarship."

Admissions experts recommend considering a range of fallback options, from lower-cost public schools to community colleges or even waiting a year to save more money. And colleges and parents alike are hedging their bets on next year and beyond.

Administrators at Ohio State University see no big immediate impact on aid from the economy but are concerned about what may happen over the longer term, said Bill Shkurti, chief financial officer. The school's endowment has fallen by as much as 30 percent from \$1.5 billion a year ago but accounts for just 2 percent of operating revenue, he said.

The University of North Carolina at Wilmington, with a much smaller enrollment and endowment, similarly has taken a hit. In a scenario likely to be repeated on many campuses, financial aid director Emily Bliss says the school is bracing for unpleasant conversations with parents about next year as it relies more on loans in its aid packages and eliminates some of the "free" money.

"Grants and scholarships won't all come through," she said. "It's difficult for us to tell families that, because our heart is breaking for them knowing what they're going through."

AP Education Writer Justin Pope contributed to this report.

On the Net:

FAFSA:<http://www.fafsa.ed.gov/>

FinAid:<http://www.finaid.org/>

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NEWS FROM NASFAA

Financial Services Committee Holds Hearing On Auction Rate Securities Market Troubles

Broker-dealer firms that underwrote, marketed and sold auction-rate securities (ARS) misled investors by not disclosing the increasing risks associated with ARS and their reduced ability to support auctions, according to the testimony of Linda Thomsen, the director of the Securities and Exchange Commission's Division of Enforcement.

Thomsen testified Thursday at the House Financial Services Committee's hearing on problems and potential resolutions to the auction-rate securities market, which froze up in mid-February when investors stopped buying ARS - effectively drying up all the liquidity in the market. ARS had grown into a \$330 billion market by early 2008. Until the ARS market froze in mid-February, auction failures were extremely rare and the market was highly liquid.

ARS and Student Loans

The current lack of liquidity in the ARS market and the Asset Backed Securities market combined with recent subsidy cuts has forced more than 130 Federal Family Education Loan Program (FFELP) loan providers to suspend or terminate a portion or all of their services. The freezing of the ARS market has hit nonprofit lenders especially hard because of their reliance on ARS to raise capital.

In her testimony before the committee, Tara E. Payne, vice president of Corporate Communications at the New Hampshire Higher Education Loan Corporation (NHHELCO), explained that thousands of students were forced to find a new, likely more expensive, student loan provider because funds NHHELCO would have used to make loans are frozen in the ARS market.

Payne testified that NHHELCO's once solid financial base had been significantly compromised by UBS Securities, LLC, NHHELCO's "long-standing, trusted" financial advisor and broker-dealer since 1997.

UBS actively encouraged NHHELCO to extend its commitment to student loan bonds, even when UBS knew that the market for these bonds was on the verge of collapse, according to Payne. UBS advised NHHELCO to reset the maximum rate on NHHELCO's taxable bonds to 17% to 18% to ensure liquidity and prevent auctions from failing.

"We know now that this was a 'scheme' to make the securities more attractive to investors and to keep NHHELCO in the Student Loan Auction Rate Securities market," Payne said.

Additionally, UBS would bid for bonds that went unsold to prevent auctions they ran from failing, but it was actively considering withdrawing its own holdings in the market. At the same time, it was advising NHHELCO to stay in the market. On February 13, 2008, UBS stopped supporting the ARS market and it collapsed, leaving NHHELCO and investors with billions of dollars frozen.

"UBS never disclosed to NHHELCO that the ARS market was at risk of freezing ... or that UBS was preparing to end its support of the market," Payne said.

On August 14, 2008, the New Hampshire Bureau of Securities Regulation announced that it was taking action against UBS Securities, LLC for fraud and failing in its fiduciary and moral duty to NHHELCO.

Fortunately, NHHELCO was able to raise \$94 million from community lenders in order to continue making loans. Congress then passed the Ensuring Continued Access to Student Loans Act, which allows the Department of Education to provide liquidity to the market and enabled NHHELCO to continue making loans.

Proposed Solutions

Payne and others testifying before the committee agreed that it is unlikely that the ARS market will recover in the near future, if ever. Payne urged lawmakers to extend ECASLA to ensure students and families will be able to finance higher education.

"In New Hampshire we know that 82 percent of borrowers in repayment believe that the opportunity to go to college would not have been possible without access to student loans," Payne said. "The credit crisis has threatened many families' ability to get a second mortgage or for students to qualify for private education loans without parents as co-signers. As a result, some low- and middle-income families may be running out of college funding options. We understand that some are turning to borrowing from 401k plans and putting tuition on credit cards."

James Preston, president and CEO of the Pennsylvania Higher Education Assistance Agency (PHEAA) also advocated for an extension of ECASLA, but noted that it was only a temporary fix and a longer-term solution is needed.

"Unless Congress and the Administration address the underlying causes of the current liquidity difficulties, there will continue to be instability in the student loan marketplace and participants will continue to cease supporting student loans," Preston said.

Preston and other nonprofit loan providers have been championing a plan to have the Treasury replicate its efforts to rescue Fannie Mae and Freddie Mac for student loan providers. Under this plan, the Treasury would stand in place of the global markets which are unable to supply sufficient capital to student lenders.

A Wide-Spread Problem

NHHELCO's experience is not unique.

Broker-dealer firms that underwrote, marketed and sold ARS used their sales forces, marketing materials, and account statements to misrepresent to their customers that ARS were safe, highly liquid investments were equivalent to cash or money market funds, according to Thomsen.

"These firms failed to disclose the increasing risks associated with ARS, including their reduced ability to support the auctions," she said. "By engaging in this conduct, those firms violated the Federal securities laws, including the broker-dealer antifraud provisions."

Federal and state law enforcement and securities regulatory officials have helped tens of thousands of investors get billions of dollars of liquidity restored to them. Before the hearing, the Financial Industry Regulatory Authority announced it reached agreements with SunTrust Banks Inc. (STI), Comerica Inc. (CMA), Washington Mutual Inc. (WM) and First Southwest Co. to settle queries about how they marketed and sold auction-rate securities. Finra said the companies have agreed to repurchase auction-rate securities bought by individual investors, charities and small businesses with \$10 million or less in their accounts between May 31, 2006, and Feb. 28, 2008. The companies didn't admit or deny wrongdoing.

Causes of the ARS Market Freeze

The ARS market encountered significant problems during early 2008 for several reasons, according to Thomsen.

One factor was the significant increase in the size of the ARS market, which had grown to \$330 billion by the time of the freeze. This larger market required the firms to find more and more customers to bid in the auctions.

An additional reason for the market seizure is the rating agencies' downgrades of the monoline insurers (e.g., Ambac Financial Group Inc. and MBIA Inc.), which provided insurance for many ARS to ensure that holders would receive repayment of their principal if the issuer defaulted. These downgrades resulted in the loss of customers willing to invest in ARS.

Another factor that contributed to the freeze is the sub-prime mortgage and credit crisis that unfolded throughout the second half of 2007, which limited the firms' ability to support the auctions with their own capital. In fact, firms stopped supporting the auctions in mid-February 2008, and the entire market froze in a matter of days. The securities became illiquid, leaving tens of thousands of customers unable to sell their

ARS holdings.

A complete list of witnesses who testified and their testimony is [available online](#).

Media Coverage

- [Nonprofit Lender Asks Congress for More Help to Stay Afloat](#) (The Chronicle of Higher Education) A paid subscription may be required.

By Haley Chitty

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Financial Institutions U.S.A. Special Report

Private Education Loans: Time for a Re-Education

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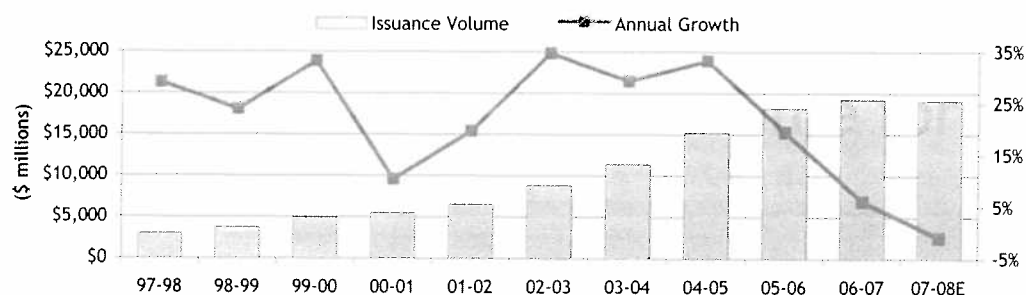
Related Research

- *Federal Student Loans: A Lesson in Lending*, Jan. 14, 2009.
- *U.S. Finance & Leasing Company Outlook 2009*, Dec. 18, 2008.
- *2009 U.S. Structured Finance Outlook*, Dec. 10, 2008.
- *Student Loan Auction Rates - The Definition of Stress*, Sept. 30, 2008.
- *An Education in Student Lending*, Feb. 5, 2007.

Overview

The rising cost of education has consistently outpaced growth in loan limits for federal student loan programs. The gap has been filled with the private education loan. Issuance of private, or nonfederal, education loans has grown from \$3bn in academic year 1997-1998 to \$19.1bn in academic year 2007-2008, according to College Board. Lenders involved in the federal student loan space have leveraged their school relationships, operating platform, and expertise to expand into private education lending. While early performance data seemed to indicate a smooth transition, the economic environment was strong and loan portfolios had yet to fully season. As the economy showed signs of weakness in 2007 and more private student loans entered repayment, cracks began to emerge in lender underwriting strategies.

Private Education Loan Growth



Source: College Board.

Deterioration in portfolio credit metrics combined with a widespread re-pricing of risk in the capital markets have made it more difficult for lenders to access the asset-backed securitization (ABS) markets for private student loan term funding. Lenders have pulled back on origination volume by tightening underwriting standards and cancelling certain school relationships, but many lenders have had to arrange expensive funding facilities for un-securitized private loans on their balance sheets. Government funding programs, like the Term Asset-Backed Loan Facility (TALF) may temporarily increase investor buying of private loan deals, but they will not truly re-ignite interest. This will necessitate re-educating investors on the risk/rewards of the product and, potentially, making changes to the loans to make them more attractive to investors. Continued deterioration in portfolio credit quality and an inability to secure cost-effective funding could result in negative rating action for student lenders.

In this report, Fitch will:

- Discuss how college costs, federal student aid, and legislation drive growth trends in the private education loan;
- Explain how dislocations in the capital markets have impacted funding options for loans and how the structure of the private student loan may need to change;
- Provide an analysis of recent credit trends for large private lenders; and

- Discuss the impact of the bankruptcy of The Education Resources Institute, Inc. (TERI) on the private education loan market.

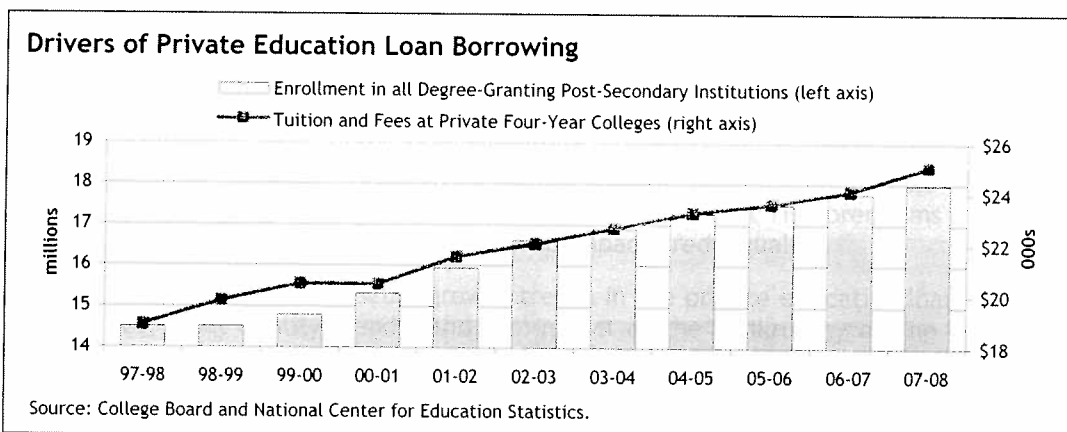
Private Education Loans

The private or nonfederal education loan has garnered increasing interest as growth in the product has surged over the last decade. Demand for private student loan ABS was relatively robust through 2006, given ample market liquidity and stable collateral performance, but investor interest waned in 2007 as market risk premiums increased and the weakening economic picture began to impact credit quality.

The following sections will discuss growth trends in the private education loan, funding alternatives, asset quality trends, and the impact of the bankruptcy of The Education Resources Institute), Inc. (TERI).

Growth

Private education loans have become an increasingly important component of education funding in the last decade, accounting for approximately 11.7% of total student aid in the 2007-2008 academic year, according to College Board, compared to 3.7% a decade ago. Growth in private student loans has been driven by increasing enrollment levels, rising tuition expenses and, until recently, static federal loan limits. Over the last ten years, enrollment in degree-granting post-secondary institutions grew 24% and average annual tuition and fees at private four-year institutions is up 32.7% and 53.3%, respectively. Meanwhile, federal Stafford loan limits remained static from October 1993 to June 2007.



Fitch expects growth of the private loan product to change; however, as higher funding costs and deteriorating collateral performance have reduced the propensity to loan and some recent legislative change may have an impact on the demand for private education loans. On the legislative front, federal Stafford loan limits have increased twice in the last two years. The Deficit Reduction Act of 2006 increased base limits for freshman and sophomores receiving loans after July 1, 2007 by \$875 and \$1,000, respectively. Fitch believes this change contributed to the 0.9% decline in private education loans issued in academic year 2007-2008, as subsidized Stafford loans increased 11.1% during the year; well above the 3.3% average annual increase over the last ten years. The Ensuring Continued Access to Student Loans Act of 2008 (ECASLA) increased federal loan limits further by allowing undergraduates to borrow an additional \$2,000 in unsubsidized loans per year after July 1, 2008.

Loan Limits for Subsidized and Unsubsidized Federal Stafford Loans

	Pre-Deficit Reduction Base Subsidized/ Unsubsidized	Post-Deficit Reduction Base Subsidized/ Unsubsidized	Pre-ECASLA Additional Unsubsidized	Post-ECASLA Additional Unsubsidized
1st year undergraduate	\$2,625	\$3,500	\$4,000	\$6,000
2nd year undergraduate	\$3,500	\$4,500	\$4,000	\$6,000
3rd year & beyond undergraduate	\$5,500	\$5,500	\$5,000	\$7,000
Graduate/Professional	\$8,500	\$8,500	\$12,000	\$12,000

Source: FinAid.org

The most critical change, however, was a provision in the Deficit Reduction Act which permits graduate and professional students to use PLUS loans to fund their entire cost of attendance, less other aid received. Historically, students funded a significant portion of their graduate programs, which tend to be more expensive than undergraduate programs, with variable-rate private education loans. Fitch expects graduate students to willingly switch to federal PLUS loans, which offer more attractive terms. PLUS loans were up a modest 1.25% in academic year 2007-2008, well-below the 12% annual average growth rate over the last decade, but Fitch believes PLUS loans will expand materially in the 2008-2009 academic year, at the expense of private loans.

Still, private education loans remain very relevant for international graduate students with no access to federal loans and in the undergraduate space, for borrowers whose parents cannot access PLUS loans, as the gap between federal loan limits and tuition expenses continues to be relatively wide. Fitch estimates that, based on current legislation, the gap between four-years of tuition and fees at a private undergraduate college and federal loan aid could be around \$50,000. Recent dislocations in the capital markets and credit deterioration resulting from portfolio seasoning and a tougher economic environment, however, have reduced the profitability, and therefore, the availability of the private education loan. Fitch believes lenders that remain in the space are taking a closer look at the terms and structuring of the product in order to make them more attractive for investors while remaining useful for borrowers.

Lenders

Many large financial institutions participate in the private student loan market, particularly those with a sizeable retail franchise, as student loans are often part of the consumer product suite. Most large banks, however, do not disclose detailed information on their student loan portfolios, as it is not a significant contributor to the overall business. Large bank lenders include JPMorgan Chase, Bank of America, Citigroup, and Wells Fargo (including Wachovia).

Private Education Loan Portfolios

(\$m)

	2002	2003	2004	2005	2006	2007	3Q 2008
SLM Corporation	\$5,822	\$8,305	\$11,482	\$16,437	\$22,588	\$28,328	\$32,800
Student Loan Corp	\$1,784	\$2,643	\$3,649	\$4,812	\$3,072	\$4,696	\$5,816
NelNet	\$75	\$92	\$90	\$97	\$197	\$275	\$276

Source: Company Filings and Fitch Estimates.

More robust information is available for non-bank student lenders like SLM Corporation, Student Loan Corp. (which is 80% owned by Citibank, N.A.), and Nelnet, Inc. The portfolios of each have grown rapidly since 2002, but growth slowed materially in 2008, given the more difficult environment.

Funding

Many private education loan providers have funded a portion of their portfolio in the ABS market in recent years, but investor risk aversion and underlying collateral deterioration has reduced the demand for private student loan ABS bonds.

SLM Corporation, the largest student loan provider, completed three private loan ABS transactions in 2006 totaling over \$5bn in issuance, but it has not completed a private loan ABS transaction since its \$2.2bn deal in March 2007. Only two private student loan deals were completed in 2008; one \$140m deal from MRU Holdings, Inc. (My Rich Uncle) completed in July, which Fitch did not rate, and a \$400m deal from the Massachusetts Educational Financing Authority, completed in August, rated 'AAA' by Fitch based on the financial guaranty provided by Assured Guaranty Corp.

Large bank lenders have been able to leverage their deposit base to replace ABS funding, but non-bank lenders have had to rely on more expensive sources of debt to fund student loan portfolios. The weighted-average cost of SLM's March 2007 term ABS deal, excluding the auction rate tranche, was approximately LIBOR plus 15 basis points. In 2008, the company paid LIBOR plus 400 basis points for its \$2.5bn, ten-year, unsecured corporate debt issuance and LIBOR plus 155 basis points for \$3.8bn in private loan ABCP capacity, which matures in February 2009.

Higher funding costs and reduced margins led many lenders, like CIT, College Loan Corporation, KeyBank, and Astrive Student Loans (a registered trademark of The First Marblehead Corporation), to exit the business altogether. Those that remain have reduced origination volume and re-evaluated underwriting criteria. SLM, for example, has tightened its underwriting standards, terminated certain school relationships and reduced origination volume by 20% year-over-year, to approximately \$6.3bn in 2008. Additionally, SLM is looking to expand the deposit base of its industrial bank, Sallie Mae Bank, in order to more cost-effectively fund the private loan portfolio. The bank had \$2.3bn in term bank deposits as of December 31, 2008 and Fitch believes the deposit base will grow to keep pace with private loan originations in coming quarters.

Still, Fitch does not believe that lenders will abandon the ABS markets altogether, as it can be an efficient way to secure term funding for private student loans. While lenders are expected to re-educate investors on the attractive risk/return attributes of the private education loan in order to reduce funding spreads, the Federal Reserve is doing its part to get the ABS market functioning again with the introduction of the Term Asset-Backed Loan Facility.

Term Asset-Backed Loan Facility (TALF)

The Term Asset-Backed Loan Facility (TALF) is being developed with the intention of restoring liquidity to the ABS markets for consumer assets; including auto, credit cards, and student loans. Under the TALF, the Federal Reserve Bank of NY is expected to make up to \$200bn of loans, which will be fully secured by eligible ABS. Eligible collateral will include, US dollar-denominated cash ABS with a long-term credit rating of 'AAA'. The underlying credit exposures must be auto loans, student loans, credit

SLM: Private Education Loan Securitization Activity

(For the Years Ended December 31; \$ 000s)

Year	Amount	# Deals
2002	\$690	1
2003	\$3,503	3
2004	\$2,535	2
2005	\$3,005	2
2006	\$5,088	3
2007	\$2,001	1
2008	-	0
Total	\$16,822	12

Source: Company Filings.

card loans, or small business loans guaranteed by the US Small Business Administration. Student loans will include federally-guaranteed loans, including consolidation loans, and private student loans. Eligible ABS must be issued after January 1, 2009 and all or substantially all of the underlying credit exposures of eligible student loan ABS must have had a first disbursement date on or after May 1, 2007.

TALF loans will have a three-year term with interest payable monthly and the loans will not be subject to mark-to-market requirements. TALF loans are pre-payable, but will not allow for substitution of collateral and any repayment of principal on eligible collateral must be used to reduce the principal amount of the TALF loan. The interest rate will be set to encourage borrowers to purchase ABS. The facility will stop making loans on December 31, 2009, unless the facility is extended by the Federal Reserve. Expectations are for the TALF to be up and running in the first quarter of 2009.

Fitch believes the TALF could be an attractive, and much-needed, funding source for private student loans originated after May 1, 2007, although enhancement levels needed to create 'AAA' securities will likely be more expensive given revised stress scenarios which reflect more recent credit conditions. But restoring more permanent liquidity to the private education loan ABS market may take more than what the TALF, alone, can accomplish. Fitch believes lenders will need to convince investors that underwriting criteria is effective enough to identify and exclude the riskier borrowers and schools that yielded significant deterioration in their portfolios in 2007 and 2008.

Additionally, lenders may need to alter the structure of the private student loan, itself, to make it more liquid and attractive for investors. The maturity of a private student loan, for example, is typically 15 to 20 years, while the maturity of an auto loan is around 5 to 6 years. Investors may not be comfortable with the longer average life of a private student loan ABS transaction and it may be more difficult and more expensive to hedge the interest rate risks of a longer-dated asset. Still, shortening the life of the underlying loan can increase the borrower's monthly payments significantly, making it more difficult to stay current on payment and, therefore, leading to higher portfolio credit losses. Clearly, there will be a balancing act for lenders to consider.

Furthermore, Fitch believes the Deficit Reduction Act, which gave graduate students the increased ability to borrow federal loans, will change the make-up of private student loan portfolios. Of the last 7 private student loan ABS transactions facilitated by First Marblehead Corp, 10.4% of collateral, on average, was related to graduate student borrowers. Going forward, portfolios will be more heavily weighted to undergraduate students. Typically undergraduates do not have an extensive credit history, which means underwriting is often based on the credit risk of the co-borrower or co-signor, which is often a parent, guardian, or spouse. As underwriting policies have tightened, the portion of new loans with co-borrowers has increased. Therefore, newer originations are not solely dependent upon the student's ability to graduate and obtain meaningful employment, as the co-borrower, who is more likely to be established and have more at risk from a credit perspective, is also responsible for making payments. This should provide investors with additional comfort.

SLM has discussed adjusting its private education loan by shortening the product term, increasing the portion of the portfolio with a co-borrower, and requiring interest-only payments while students are in-school.

Asset Quality

Unlike federal student loans, private education loans do not come with a government guarantee against default, although the loans are generally non-dischargeable in bankruptcy and lenders will often obtain third-party insurance to limit the downside

Asset Quality: Private Education Loans

30+ Day Delinquencies/Loans in Repayment

	2002	2003	2004	2005	2006	2007	3Q 2008	Average
SLM Corp	7.7%	9.2%	8.4%	7.7%	10.1%	9.3%	9.6%	8.8%
NelNet	14.4%	12.5%	10.1%	7.8%	5.6%	4.7%	5.3%	8.6%
Student Loan Corp	NA	3.0%	2.3%	2.5%	5.2%	4.0%	5.2%	3.7%

Loans in Forbearance/(Loans in Repayment + Forbearance)

	2002	2003	2004	2005	2006	2007	3Q 2008	Average
SLM Corp	9.8%	10.0%	7.5%	9.9%	9.2%	13.9%	11.5%	10.3%
NelNet	17.5%	22.1%	3.1%	4.2%	5.4%	7.9%	5.2%	9.4%
Student Loan Corp	NA	NA	6.6%	7.1%	6.6%	8.1%	6.2%	6.9%

Net Charge-offs/Average Private Loans in Repayment

	2002	2003	2004	2005	2006	2007	3Q 2008	Average
SLM Corp	2.2%	1.9%	1.9%	1.9%	1.6%	3.1%	3.4%	2.3%
NelNet	3.5%	9.0%	10.6%	0.9%	1.1%	0.9%	2.4%	4.1%
Student Loan Corp	NA	0.4%	0.4%	0.4%	0.7%	1.4%	2.9%	1.0%

Private Loans in Repayment/Private Loans

	2002	2003	2004	2005	2006	2007	3Q 2008	Average
SLM Corp	53.1%	51.6%	52.5%	49.7%	50.7%	50.3%	52.2%	51.4%
NelNet	48.8%	56.3%	72.1%	68.4%	54.3%	54.6%	59.1%	59.1%
Student Loan Corp	NA	47.7%	51.8%	52.8%	37.6%	41.2%	38.1%	44.9%

Private Allowance/Private Loans in Repayment

	2002	2003	2004	2005	2006	2007	3Q 2008	Average
SLM Corp	6.3%	5.9%	5.1%	3.4%	3.4%	8.2%	7.8%	5.7%
NelNet	5.6%	12.1%	11.0%	20.1%	17.2%	14.0%	15.2%	13.6%
Student Loan Corp	NA	0.1%	0.2%	0.1%	0.6%	1.5%	4.6%	1.2%

Note: Metrics annualized in 2008 where appropriate.

Source: Company Filings and Fitch Estimates. NA - Not Available.

risk. Federal student loans are underwritten based on need, but private education loans are underwritten based on a credit evaluation of the borrower and/or co-borrower and risk-based pricing is employed. While early statistical data of collateral performance was sound, Fitch remained cautious about early credit data, as the surge in origination volume meant that only a small portion of loans outstanding were in repayment status. In recent years, as loan portfolios have seasoned and the economy has slowed, credit performance of the private education loan product has deteriorated.

Private student loan credit performance metrics for SLM Corp, Nelnet, Inc. and Student Loan Corp (SLC) are presented in the table above. Nelnet's portfolio is significantly smaller than the other lenders, but many metrics have followed a similar pattern. Surprisingly, delinquency metrics were actually down at the end of 2007 relative to the prior year, but Fitch believes this was because lenders were employing forbearance policies more aggressively, perhaps believing that a borrower's inability to pay was a temporary blip. But delinquency rates rebounded in 2008, as lenders pulled back on forbearance, after realizing the economic downturn would have a more prolonged impact on a borrower's ability to pay, particularly given the significant increase in the unemployment rate. Borrowers receiving forbearance are being awarded shorter grace periods to ensure they do not get out of the habit of paying every month. SLM's forbearance levels declined from 13.9% of loans in repayment and forbearance in 2007 to 11.5% in 3Q2008, while STU's declined from 8.1% to 6.2%. Fitch believes forbearance levels may decline further in 2009, as lender's award payment programs only to borrowers that they believe can truly benefit, but the decline will accelerate the recognition of credit losses into current periods.

From a net charge-off perspective, metrics have deteriorated for all three issuers since 2006, with SLC increasing 220 basis points to 2.9% as of September 30, 2008, and SLM increasing 180 basis points to 3.4%. Still, both issuers believe they have identified the main source of credit deterioration (outside normal pressure from economic weaknesses) and that is: lending to students attending schools with lower graduation rates and lower average earning potential, given the degree programs offered.

SLM has divided its portfolio into traditional schools and non-traditional schools, where the latter refers to 'loans made to borrowers that are expected to have a high default rate as a result of a number of factors, including having a lower tier credit rating, low program completion and graduation rates, or where the borrower is expected to graduate, a low expected income relative to the borrower's cost of attendance'. The dispersion in portfolio performance is clear, with the traditional portfolio posting net charge-offs of 2.5% in the fourth quarter of 2008, while the non-traditional portfolio posted net losses of 16.1%. Delinquency statistics are also significant with traditional and non-traditional delinquencies of 7.1% and 28.9%, respectively. SLM has ceased lending to non-traditional schools, but Fitch believes the impact of the \$4.95bn portfolio will remain for some time as only 60.6% of the portfolio was in repayment as of December 31, 2008.

SLM Corporation - Private Portfolio Distribution

(For the Years Ended December 31; \$m)

	2006	2007	1Q 2008	2Q 2008	3Q 2008	4Q 2008
Traditional Private Education Loans						
Traditional Loans, End of Period	19,533	25,791	27,502	28,349	30,060	30,949
Traditional Loans in Repayment	9,835	12,711	12,683	14,433	14,605	17,715
30+ Delinquencies/Loans in Repayment	NA	5.2%	4.6%	4.9%	6.3%	7.1%
Loans in Forbearance/Loans in Forbearance and Repayment*	NA	12.8%	15.5%	12.0%	11.0%	6.7%
Net Charge-Offs/Average Loans in Repayment	0.6%	1.5%	1.7%	2.0%	2.0%	2.5%
Allowance/Loans in Repayment	1.8%	3.5%	3.7%	3.3%	3.9%	4.0%
Non-Traditional Private Education Loans						
Non-Traditional Loans, End of Period	3,449	4,580	4,811	4,873	4,952	4,945
Non-Traditional Loans in Repayment	1,819	2,155	2,187	2,451	2,641	2,997
30+ Delinquencies/Loans in Repayment	NA	26.3%	23.3%	24.0%	26.3%	28.9%
Loans in Forbearance/Loans in Forbearance and Repayment*	NA	19.4%	21.4%	18.5%	14.4%	9.0%
Net Charge-Offs/Average Loans in Repayment	7.2%	11.9%	12.9%	15.0%	12.9%	16.1%
Allowance/Loans in Repayment	11.8%	36.3%	36.6%	33.4%	29.8%	26.4%

* Annualized.

Source: Company Filings.

Net charge-offs on SLM's traditional portfolio, which represents about 86% of the total private loan portfolio, have increased as well, given the tougher economic environment, with net losses rising from 0.6% in 2006. Fitch expects credit metrics to deteriorate further in 2009, as the unemployment picture remains weak for borrowers in and just entering repayment status.

SLC has also segmented its private loan portfolio into the following three categories: Insured CitiAssist, Uninsured CitiAssist Standard and Uninsured CitiAssist Custom. Standard loans are primarily related to CitiAssist loans that have been approved based on standard underwriting criteria and were originated on or after January 1, 2008. Custom loans are related to loans made to non-traditional students or loans with less stringent underwriting standards.

Approximately 78% of the private loan portfolio carries private insurance through

United Guaranty Commercial Insurance Company of North Carolina/New Hampshire Insurance Company or through Arrowood Indemnity Company. Risk-sharing deductibles range from 5% to 20% up to maximum loss levels. As expected, net charge-offs on Insured CitiAssist loans remain relatively low at 0.8%, as of September 30, 2008, but SLC stopped insuring new CitiAssist loan originations on January 1, 2008, believing that higher loan losses would be more than offset by declines in insurance premiums paid.

Student Loan Corp - Private Portfolio Distribution

(For the Years Ended December 31; \$m)

	2006	2007	1Q 2008	2Q 2008	3Q 2008
Insured CitiAssist					
Loans, End of Period	\$2,410	\$3,870	\$4,489	\$4,590	\$4,523
Loans in Repayment	\$733	\$1,443	\$1,469	\$1,706	\$1,605
30+ Delinquencies/Loans	6.5%	3.7%	4.6%	3.5%	5.3%
Loans in Forbearance/Loans in Forebearance and Repayment	8.3%	9.3%	13.4%	9.2%	11.8%
Net Charge-Offs/Loans in Repayment*	NA	NA	0.4%	0.6%	0.8%
Allowance/Loans in Repayment	0.1%	0.2%	0.4%	0.3%	0.6%
Uninsured CitiAssist					
Loans, End of Period	\$662	\$826	\$1,033	\$1,230	\$1,293
Loans in Repayment	\$423	\$494	\$530	\$580	\$609
30+ Delinquencies/Loans	2.9%	4.8%	5.1%	4.6%	4.5%
Loans in Forbearance/Loans in Forebearance and Repayment	3.5%	4.4%	7.2%	7.1%	8.5%
Net Charge-Offs/Loans in Repayment*	NA	NA	6.1%	8.0%	7.3%
Allowance/Loans in Repayment	1.6%	5.4%	6.8%	11.6%	15.0%
Loans Covered by Risk-Sharing Agreements with Schools	75.9%	59.7%	47.7%	40.3%	37.3%

* Annualized.

Source: Company Filings and Fitch Estimates.

Net losses on the uninsured portfolio amounted to 7.3% in the third quarter of 2008. Standard loans account for approximately 29% of the uninsured portfolio while custom loans account for about 71%. Net charge-offs on the standard portfolio amounted to 0.2% in the third quarter of 2008, while losses on the custom portion amounted to 9.3%. In the second quarter of 2008, SLC discontinued relationships with schools that generated higher-risk uninsured CitiAssist originations, which Fitch believes would be included in the custom portion of the portfolio. SLC has tightened underwriting criteria in response to the economic environment and plans additional tightening in the near-term.

A portion of the uninsured portfolio is covered by risk-sharing agreements with schools and universities, although that portion has been on a declining trend; from 75.9% of the uninsured portfolio in 2006 to 37.3% in the third quarter of 2008. Under the agreements, the school reimburses a specified percentage when losses exceed a certain threshold or the school pays a percentage of the total disbursed amount to compensate for future expected losses. Lenders to schools with riskier borrower profiles are subject to adverse selection.

While lenders like SLM and SLC are segmenting portfolios and modifying underwriting standards; balance sheets and securitization trusts continue to contain a significant amount of loans already originated which have yet to enter repayment status. As of September 30, 2008, only 38.1% of SLC's private loan portfolio was in repayment status, compared to 57.7% of SLM's portfolio at year-end. Fitch believes lenders have and will continue to build reserves in anticipation of poorer performance of loans made to 'non-traditional' schools and to incorporate general portfolio weakening due to the weaker economic environment. SLM's allowance as a percent of loans in repayment amounted

to 7.2% at year-end 2008 and SLC's allowance amounted to 4.6% at the end of the third quarter 2008.

The fact that private education loans are non-dischargeable in bankruptcy has come under an increasing amount of scrutiny in recent years, in the face of bankruptcy reform and political transition. Consumer protection has been a hot topic in recent months and Fitch believes recent developments in the mortgage market aimed at reducing a borrower's debt burden could expand into other asset classes. Consumer protection advocates have also highlighted the higher interest rates charged by lenders on private loans. The imposition of interest rate caps or limits would also make the private loan less attractive to lenders and investors.

The Education Resources Institute, Inc.

The Education Resources Institute, Inc. (TERI), a private, non-profit corporation and the largest guarantor of private student loans, filed for Chapter 11 bankruptcy protection on April 7, 2008. TERI provided private education loan guarantees to commercial banks underwriting loans according to its articulated standards. Participating banks included Bank of America, Charter One Bank, JPMorgan Chase, and RBS Citizens. These banks would often partner with First Marblehead Corporation (FMD), a student loan facilitator, to structure private student loan ABS transactions. FMD conducted ABS transactions out of its wholly owned subsidiary, National Collegiate Funding LLC and TERI guaranteed 100% of principal and accrued interest on defaulted loans in the trusts.

As discussed in the Asset Quality section, private education loan credit performance began to deteriorate in 2007 and early 2008 as the economic picture weakened. But compounding the issue for TERI was that a large portion of the collateral included in the National Collegiate Student Loan Trust (NCSLT) was originated through the direct-to-consumer channel (as opposed to the school channel), which has been more susceptible to fraud, as there is typically no verification with schools to ensure that funds are being used to pay a borrower's tuition. On average, of the last 7 NCSLT ABS transactions, completed in 2006 and 2007, approximately 80% of loan collateral was originated in the direct-to-consumer channel. So as the economy weakened, some TERI-guaranteed portfolios deteriorated quickly, given the higher direct-to-consumer exposure. TERI received an increasing amount of default claims and its liquidity profile weakened.

Fitch has downgraded and/or placed on Rating Watch Negative numerous classes of NCSLT ABS due to deteriorating collateral performance, beyond Fitch's expectations, combined with operational uncertainties related to the bankruptcy proceedings of TERI and concerns regarding the level of recoveries on defaulted loans in a post-TERI environment. Ongoing analysis is focusing on default level and loss timing projections for each pool. Depending on the outcome, Fitch expects that ratings currently on Rating Watch Negative could be downgraded by an additional zero to three notches.

Fitch believes the impact of the TERI bankruptcy is not limited to ABS transactions, as there are TERI-guaranteed loans residing on bank balance sheets which may, therefore, end up performing well-below management expectations. While student loans are generally not a material component to a large commercial bank's profitability, unexpected losses on what were believed to be insured loans, will only add to the challenges facing banks in the current environment.

Summary

Fitch believes tighter underwriting standards and structural changes to the private education loan product will help peak investor interest in the collateral, but true market liquidity is not likely to return until investors have more information about how

private student loan portfolios perform in the current stressed environment and the ABS markets are fully functioning without government intervention.

Even so, ABS spreads are not likely to return to pre-2007 levels, which means that many lenders that have temporarily cut origination volume may need to reassess the long-term risk/return attributes of the business. Based on these dynamics, the private student loan market will find a new equilibrium; however, this may not align with public policy interests and could necessitate further legislative action to restore a healthier balance of financing for this asset class.

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Paying for college

State stepping in as banks bail out of student loans

As the number of private lenders shrinks, Utah agency expects to help thousands of borrowers

By Brian Maffly
The Salt Lake Tribune
Salt Lake Tribune

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For the first time, the state of Utah has begun originating student loans, a shift that will ensure that any Utah college student who needs financial assistance can get it, although it will cost more.

The Utah Higher Education Assistance Authority (UHEAA), the agency that oversees financial aid to Utah students, is bracing for loan applications worth \$100 million this academic year after big banks all but abandoned the federally guaranteed loan program.

Last fall, Congress cut what participating lenders could make on student loans at the same time money became more scarce. That created a double disincentive for financial institutions to lend to college students. With fewer lenders available, Utah students are expected to flock to UHEAA, agency director David Feitz told his board Thursday.

"We would rather have a full cadre of lenders, but that is unlikely to happen in the near future until Congress raises the yields," he said.

Adding to the pressure was a recent move by Congress to raise the maximum students can borrow by \$2,000 (to \$5,500 for freshman, \$6,500 for sophomores and \$7,500 for upperclassmen). Feitz estimated UHEAA will see applications worth one-fourth of the state's total student loan volume this coming year, but he won't know how much until students begin applying as they return to school.

"It could be \$60 million, it could be \$200 million," Feitz said of a development that represents a profound change in the way UHEAA conducts business.

UHEAA has access to \$121 million to lend over the coming academic year.

The U.S. Department of Education promises to buy participating states' loans issued this year under the Federal Family and Education Loan program (FFELP). This would enable states to "recycle" the money back to students in the form of new loans. The UHEAA board voted unanimously Thursday to approve Utah's participation in the complex arrangement.

Feitz cautioned that the program, which runs only for one year, isn't a permanent solution to the liquidity mess that has caused "tremendous chaos" in the \$50 billion system that subsidizes the popular Stafford and PLUS loan programs.

"Now we're calling on Congress and the departments of Treasury and Education to take additional action to further stabilize the student loan program for years to come," he said.

In recent months four banks - Wells Fargo, Zions, J.P. Morgan Chase and Key - pulled out of Utah's program, leaving only U.S. Bank. Fifteen credit unions, led by America First, still lend to students, but the banks' departure left a vacuum. Wells Fargo and Zions were the top lenders last year, accounting for more than half of the state's student loan volume.

Lenders also have become picky about which institutions they work with. One Utah school, Snow College, found itself with no lenders, so UHEAA last month began lending directly to students at the Ephraim school.

"We're in a pretty good place, a much better place than our sister agencies across the country," board chairman David Jordan said. "From the students' perspective, this will work. We will be able to help them without depleting our resources."

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Utah students can expect to pay more for college loans under steps taken by the Utah Higher Education Assistance Authority to preserve universal access to federally guaranteed loans. But the news isn't all bad.

"I'm not aware of lenders offering better terms than what UHEAA is offering," said John Curl, the University of Utah's financial aid director. "We encourage students to research who they're going to get loans from and find the best terms they can get. They are going to have to pay more interest; that's unfortunate."

Congress last year cut the rate on some student loans from 6.8 to 6 percent. But in order to participate in an emergency federal bail-out measure, Utah slashed two rate reductions. Until now, students who had payments automatically drawn from their accounts received a 1.25-point reduction and another 2-point reduction after four years of timely payments. Losing these benefits adds \$1,763 to the cost of servicing a \$15,000 loan.

On Thursday, the UHEAA board suspended issuing consolidation loans to avoid tying up scarce capital needed to serve current students. Former students looking to simplify repayment plans have other options for consolidating their loans in the federal program.

But Utah students still get breaks on up-front costs of the most common loans, Stafford and PLUS. UHEAA continues to cover the 1 percent origination fee and 1 percent default fee, translating into a \$100 subsidy on a \$5,000 loan.

- Brian Maffly

Financial aid

* **Students who are considering borrowing** for college for the upcoming school year should start researching their options now, said John Curl, financial aid director at the University of Utah.

* **Students should consult the financial aid office** at their school, check Web sites that serve as information clearinghouses, such as finaid.org, or www.uheaa.org, the Web site for the Utah Higher Education Assistance Authority.

The Boston Globe A late try to salvage student loans Patrick calls on pension board, colleges to invest in agency bonds By Casey Ross, Globe Staff | August 7, 2008

Governor Deval Patrick has asked the state pension fund to invest \$50 million and will ask Harvard University and other local colleges to invest millions more to provide student loans to thousands of families struggling to pay college tuition bills that are due in the coming weeks.

Patrick's 11th hour proposal, floated among key officials yesterday, would prop up the troubled 26-year-old Massachusetts Educational Financing Authority, which announced last week that it would be unable to provide student loans for this school year because of turmoil in the nation's credit markets.

The proposal would entail the investment funds buying portions of a \$425 million bond sale that MEFA is planning this month. The agency would use the proceeds to finance student loans.

"We have 40,000 students and families who need help, and we're right up against it," Patrick said in an interview with the Globe last night. "This is a sound investment for the pension board and the endowments."

The governor and his aides, along with state lawmakers, have been brainstorming ways to restore student loan funds for the past week. MEFA had previously offered low-cost, fixed-rate loans, but now borrowers have to look to other lenders whose loans may carry higher rates and higher costs.

Yesterday, Patrick's top budget aide, Leslie Kirwan, asked the state pension board to consider buying \$50 million of the upcoming MEFA bonds. Administration officials also hope the state investment would be seen as a show of confidence in the bond market and MEFA, spurring purchase by other investors that could finance more loans.

Patrick said he intends to call officials today from Harvard, Boston College, the University of Massachusetts, and the Massachusetts Institute of Technology, among other schools, about making similar investments in MEFA bonds.

The chairman of the state pension board, state Treasurer Timothy Cahill, was noncommittal about Patrick's request, but said the board would consider it.

The pension fund staff "will examine the options legally available to invest in any debt issuance set up by MEFA and report back to the trustees before any action is taken," Cahill said through a spokeswoman.

With \$51.7 billion in assets, the pension fund invests monies for state employees and retirees. And while it is unusual for the fund to use anything other than financial returns as grounds for investment, the board has already committed funds to local projects that are intended to produce economic and social benefits within Massachusetts. The program was a major policy goal of Cahill, who got the pension board to adopt it in 2003.

Even without Cahill's commitment, Patrick has a strong start on getting the board to adopt his measure, as he appoints three of its nine members, one of whom is Kirwan.

Another board member, Robert Brousseau, reacted favorably to Patrick's request and said he did not hear strong objections from fellow board members at yesterday's meeting.

"I can't see anybody opposing it, but we have to see the parameters of the investment and what form it would take," said Brousseau, who represents teachers on the board.

Patrick said he is seeking swift consideration from the pension fund board because MEFA is planning to hold its bond sale within two weeks.

"We need action," he said. "If they need to call a special meeting to approve this, then I hope they will."

Meanwhile, representatives of the local colleges said the institutions will consider the investment.

"We're always more than happy to have discussions with the governor," said John Longbrake, a spokesman for Harvard University, the governor's alma mater. "We welcome the opportunity to learn more about the challenges MEFA is facing and to discuss ways to address them."

Robert Connolly, a spokesman for UMass President Jack Wilson, said: "This is an idea we're definitely willing to explore. We do see it as a potential win-win in terms of providing the university with a sound investment while helping families cope with their financial aid challenges."

Officials at the student lending agency, meanwhile, said Patrick's plan carries minimal risk to the investment funds because MEFA's bonds provide reliable returns. Executive Director Tom Graf said the default rate on the authority's loans is less than 1 percent. "This plan allows" the pension board "to make a stable investment that is especially warranted in this financial climate," he said.

The problems in the bond market, which started with the foreclosure crisis and spread to other credit markets, have imperiled student lenders across the country, prompting more than 50 agencies to stop making federal or private loans.

Graf said the size of the upcoming bond sale may change based on investor interest. If the sale is a success, he hopes the agency will then be able to offer loans with rates below 8.5 percent, which is the current charge for Federal Plus loans. Last year, the authority's private 20-year loan rate was 6.39 percent.

The agency made \$400 million in private loans in the last school year, and another \$110 million in federal student loans.

State Senator Brian A. Joyce, who authored a letter last week signed by other legislators urging Patrick to support MEFA, applauded the governor's actions. "This critically important to an awful lot of Massachusetts families," he said. "The governor can use his bully pulpit to ask for some assistance, and I wholeheartedly support what he's doing."

Casey Ross can be reached at cross@globe.com. ■

AP Associated Press

NH working on student loan problem

By Kathy McCormack, Associated Press Writer | August 6, 2008

CONCORD, N.H. --Turmoil in the financial markets has driven many lenders out of the student loan market, leaving students struggling to pay their fall tuition. That's a problem that New Hampshire officials are working on.

Many students "are being frozen out from having the loans they were expecting," said Mark Connolly, director of the state Bureau of Securities Regulation.

"In the last several days, our office has been engaged in discussions with some of the participants who have been involved in securitizing these loans in our state," Connolly said Wednesday.

"We are trying to encourage these participants to bring liquidity to these loans so students can plan for their academic year. If we are unable to successfully encourage these participants to bring liquidity to our student loan market, we will take regulatory action that in part will address the issue," Connolly said.

Connolly said his office has been involved with many other states in looking at the auction-rate securities market -- short-term investments that are a popular way for companies and some wealthy investors to store their cash -- which has rippled into the student loan market.

Dozens of lenders have left the federal student loan program, though where that has happened other lenders have stepped in or students have turned to a smaller program in which the Education Department makes loans directly to students.

Last month, the Massachusetts Educational Financing Authority, which provided more than \$500 million worth of college financing last year, said it would not provide private loans this year because of turmoil in the financial markets. That affected about 650 New Hampshire college students from Massachusetts.

Earlier this year, the New Hampshire Higher Education Loan Corp., the state's leading provider of student loan financing, said it was suspending its private loan program because of market conditions. That meant more than 6,000 students had to find another place to borrow money.

On the Net:

<http://www.sos.nh.gov/securities/> ■