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Plan to Change Student Lending Sets Up a Fight

By DAVID M. HERSZENHORN

WASHINGTON — The private student lending industry and its allies in Congress are maneuvering to thwart a plan by President Obama to end a subsidized loan program and redirect billions of dollars in bank profits to scholarships for needy students.

The plan is the main money-saving component of Mr. Obama's education agenda, which includes a sweeping overhaul of financial aid programs. The Congressional Budget Office says replacing subsidized loans made by private banks with direct government lending would save $94 billion over the next decade, money that Mr. Obama would use to expand Pell grants for the poorest students.

But the proposal has ignited one of the most fractious policy fights this year.

Because it would make spending on Pell grants mandatory, limiting Congressional control, powerful appropriators are balking at it. Republicans say the plan is proof that Mr. Obama is trying to vastly expand government. Democrats are divided, with lawmakers from districts where lenders are big employers already drawing battle lines.

At the same time, the private loan industry, which would have collapsed without a government rescue last year, has begun lobbying aggressively to save a program that has generated giant profits with very little risk.

"The administration has decided that it wants to capture the profits of federal student loans," said Kevin Bruns, executive director of America's Student Loan Providers, a trade group that is fighting Mr. Obama's plan.

To press its case, the nation's largest student lender, Sallie Mae, has hired two prominent lobbyists, Tony Podesta, whose brother, John, led the Obama transition, and Jamie S. Gorelick, a former deputy attorney general in the Clinton administration.

For lenders, the stakes are huge. Just last week, Sallie Mae reported that despite losing $213 million in 2008, it paid its chief executive more than $4.6 million in cash and stock and its vice chairman more than $13.2 million in cash and stock, including the use of a company plane. The company, which did not receive money under the $700 billion financial system bailout and is not subject to pay restrictions, also disbursed cash bonuses of up to $600,000 to other executives.

Sallie Mae said that executive compensation was lower in 2008 than 2007 and that the stock awards were worthless in the current market.

Critics of the subsidized loan system, called the Federal Family Education Loan Program, say private lenders have collected hefty fees for decades on loans that are risk-free because the government guarantees repayment up to 97 percent. With the government directly or indirectly financing virtually all federal student loans because of the financial crisis, the critics say there is no reason to continue a program that was intended to inject private capital into the education lending system.

Under the subsidized loan program, the government pays lenders like Citigroup, Bank of America and Sallie Mae, with both the subsidy and the maximum interest rate for borrowers set by Congress. Students are steered to the government's direct program or to outside lenders, depending on their school's preference.

Private lenders say they still provide valuable service, marketing, customer relations, billing, default prevention and collection of delinquent loans. The lenders say the budget savings could be achieved without ending their role and are pushing to keep the current system in place, including an arrangement approved by Congress last year by which they are paid to originate loans but can then resell them to the government.

Martha Holler, a spokeswoman for Sallie Mae, said the company wanted a compromise. "To be clear, there are those who are fighting to preserve the historic financing structure for federal student loans," she wrote in an e-mail message following up on a telephone interview. "Sallie Mae is not among them. In fact, we support constructive alternatives that would generate a similar level of taxpayer savings to achieve the administration's important goals."

Lenders are also emphasizing the jobs they provide.

Sallie Mae's chief executive, Albert L. Lord, held a town-hall-style meeting last week at the company's loan center in Wilkes-Barre, Pa., with two Democrats, Senator Bob Casey and Representative Paul E. Kanjorski, to announce the return of 2,000 jobs that were sent overseas in 2007.

Mr. Lord, in his opening speech, insisted that Mr. Obama's proposal offered new opportunities, but he said he would fight to keep the current system mostly intact.

"We can either meet or beat the budget savings that are in the president's budget with the exact same system that we have got working now with maybe a few tweaks," he said.

But to preserve a profitable role for private lenders and still achieve Mr. Obama's savings seems extremely difficult if not impossible.

Last year, to keep education financing from drying up, Congress expanded the government's role, including the repurchase of loans, which Sallie Mae and some other lenders say should be mandatory going forward.

"When you add that all up, a very legitimate question to ask is why do we even need private lenders," said Representative Timothy H. Bishop, Democrat of New York and a former provost of Southampton College.

For Mr. Bishop and many other education advocates, Mr. Obama's plan to expand the existing direct loan program used by more than 1,500 schools is obvious and long overdue.

But the administration has a fight on its hands.

“The president’s proposal,” Representative Allen Boyd, Democrat of Florida, said in a floor speech, “could be detrimental to thousands of employees who serve in the current student loan industry throughout this country, 650 of which are located in Panama City, Florida.”

In some states, student loans are administered by quasi-governmental agencies that benefit the same as private lenders. To appeal to these states, the administration has proposed $500 million a year for financial literacy programs and other services the agencies provide.

Political opposition may be harder to overcome.

Representative Howard P. McKeon of California, the senior Republican on the education committee, said Democrats should not cut out private lenders. “A government-run, one-size-fits-all program is not the answer,” he said.

But some lawmakers have no sympathy for an industry now kept afloat by taxpayers.

“If the banks complain that they are getting cut out,” said Representative Barney Frank, Democrat of Massachusetts, “too bad.”

At the Wilkes-Barre event, Mr. Lord of Sallie Mae acknowledged his industry’s reliance on the government. “I don’t see private capital financing student loans, certainly any time soon,” he said.

Even as lenders fight the president’s plan, Sallie Mae and others are bidding for work that will remain if it is adopted — contracts for loan servicing and other back office operations.

The president’s plan would use the money from direct lending to help increase Pell grants and make them mandatory, with annual increases tied to inflation, providing a much-needed measure of certainty for students. That would limit Congressional control over the grants, an idea appropriators are not keen on, but the White House and Congressional leaders say they are open to negotiation.

Anticipating a ferocious legislative battle, Representative George Miller, Democrat of California and chairman of the education committee, is weighing all options.

“Chairman Miller’s priority is to make our federal student loan programs as reliable, sustainable and efficient as possible for students, families and taxpayers,” his spokeswoman, Rachel Racusen, said.

Jonathan D. Glater contributed reporting.