
*The FFELP
School-as-Lender
Model*

A Report by Dr. Samuel M. Kipp, III

Table of Contents

Foreword	ii
Executive Summary	iv
Introduction	1
Background	2
Institutions identified as currently having a school-as-lender program	3
Causes of the recent increased interest in school-as-lender programs	3
Institutional Eligibility	4
Eligibility requirements to become a FFELP school lender	4
Process to become a FFELP school lender	4
The Structure of School-As-Lender Programs	6
Sources of funding, origination, servicing, purchasing, and other support functions	6
Potential Benefits to Institutions	7
Revenue sources for institutions with school-as-lender programs	7
Amount and uses of new institutional revenues.....	7
Potential Benefits to Students	9
Which students receive school-as-lender benefits? What form do they take?.....	9
How competitive are borrower benefits in school-as-lender programs?	9
Potential Risks to Institutions	12
Institutions that Might Benefit from a School-As-Lender Program	14
Characteristics of Current School-As-Lender Institutions	15
Extent of borrower choice of lender at school-as-lender institutions	15
Relationship between federal and private loans at school-as-lender institutions	17
Possible role of “opportunity funds” at some institutions	18
Federal loan volume growth in school-as-lender programs.....	18
Questions Institutions Need to Answer in Considering a School-As-Lender Program	20
Summary	21
Appendix A: Institutions with School-As-Lender Programs by 2003-04	23
Appendix B: Survey of School-As-Lender Institutions	25
Interview Questionnaire.....	26

Foreword

In recent years, there has been a resurgence of interest in a graduate student loan model that has been around for decades — school as lender. Under the Higher Education Act, schools are permitted to participate in the Federal Family Education Loan Program (FFELP) as lenders to their graduate and professional students.

Since Access Group is one of the largest providers of loans for graduate education, the school-as-lender model is of particular interest and importance to the schools and students that we serve. Further, as a nonprofit organization, it is part of Access Group’s mission to provide information that will encourage positive education financing practices within the graduate community. It is to that end that the following report was commissioned.

Early in 2003 Access Group engaged Kipp Research and Consulting to conduct a study examining the current school-as-lender phenomenon — who’s using this model, how, and why. The resulting report was based upon independently gathered research, as well as upon a phone survey of school-as-lender institutions that explored the structure of the program, along with the expectations, objectives, and results, at each institution.

As described in the report that follows, schools today generally consider implementing a school-as-lender model for two primary reasons: 1) the opportunity to secure a new source of revenue, either to cover general institutional expenses or for institutional grants and scholarships; or 2) the desire to provide a quality, low-cost loan program for their students. Given the current economic conditions, the need for additional revenue is understandable, particularly at state institutions that have experienced cuts in state funding in recent years, and at private institutions whose endowment funds have not kept pace with rising costs and demands for financial assistance. And, on the surface, it may appear that the school-as-lender model offers a streamlined, “single-lender” approach similar to Direct Lending, while providing greater control for the school and potentially lower costs for students.

However, the school-as-lender model is also filled with challenges that deserve to be considered and addressed. Institutions that rely on a school-as-lender model primarily to produce additional revenue, often offer loans that are more costly to students than other loans readily available in today’s competitive student loan market. This presents an inherent conflict of interest for financial aid administrators. Aid administrators have traditionally served as “trusted advisors” to students who must borrow to finance their education. This role is based, in part, on federal guidelines concerning institutional responsibilities to provide consumer information and loan counseling relative to the federal student loan programs. Under a school-as-lender model, however, administrators may face pressure to promote a less competitive school loan offering as being in the best interest of the institution, instead of focusing on which loan product will best serve the graduate student borrower.

In addition, as noted above, current federal regulations limit school-as-lender offerings to graduate and professional students. Schools are barred from acting as lender to undergraduates except in cases where students are unable to obtain a loan from a traditional lender, which is rare. Yet the revenue gained from a school-as-lender program is often used to fund scholarships and grants to undergraduates — at the expense of graduate and professional students, who likely are already the most deeply indebted student group within the university. And while graduate schools may bear the administrative burden related to a school-as-lender program, the revenue generated is often used to cover general university — not graduate school — expenses.

The decision to participate in a school as lender model is a choice that schools may arrive at for the best possible reasons — to bring value to their institution and their students. But we believe that the decision to implement a school-as-lender program also carries responsibilities related to issues of disclosure and borrower choice.

We encourage schools that offer a school as lender program to provide, in good faith, full disclosure about the program to its student borrowers. Given the fact that it is the institution that establishes the cost of tuition, fees, and other expenses that impact the amount a student must borrow, students should know that the institution will receive revenue as a direct result of that borrowing. Schools should also consider providing borrowers with information about how the institution will use the revenue that is generated by the school as lender program. In addition, we believe that it is important for schools that offer a school-based loan program to disclose that other student loan options may be available at a comparable, or even a lower, cost. School administrators that promote only the school program and fail to provide information about other loan choices, compromise the integrity of their role as “trusted advisor.” Under a policy of full disclosure, borrowers will have the opportunity to make an informed decision about their loan provider. Which brings us to the second issue — borrower choice.

It is important to remember that school as lender is an option available under FFELP. In the FFEL program, it is the borrower who has the final choice in selecting a student loan provider, not the institution. While the institution may offer a school-as-lender program, the borrower has the right to choose a different FFELP lender and have the institution honor that choice. In fact, it may be especially important for schools that offer a school-as-lender program to demonstrate that they are, in fact, honoring borrower choice by providing borrowers with information about other loan alternatives along with information about the school program.

Access Group has always taken the position that we want to partner with schools, serving schools and their students to the best of our ability, consistent with their needs and our mission. That has not changed. We respect the right of every college and university to choose an education financing model that best meets the needs of the institution and its students.

We hope you find this report to be valuable and informative.



Daniel R. Lau
President and CEO
Access Group, Inc.

Executive Summary

Current economic conditions, state budget cuts, reductions in endowment earnings or even losses, and the search for new revenue sources clearly are the most significant factors in the recent upsurge of institutional interest in school-as-lender programs. Aggressive marketing of these programs by some members of the student loan industry have found a sympathetic ear at institutions looking for additional revenue.

A total of 58 institutions have been identified as having school-as-lender programs in place as of September 30, 2003. About a dozen more are actively investigating the feasibility of starting one. Serving as FFELP lenders to their own graduate students, these institutions currently represent only a tiny fraction of all institutions with graduate programs, but their number has more than doubled in just the past two years.

This report analyzes these institutions and the full range of issues surrounding the school-as-lender model. It seeks to answer three crucial questions:

- What are the reasons for the recent growth in school-as-lender programs?
- What do institutions with graduate and first-professional programs need to know about the pros and cons of this lending model?
- What impact will these changes have on the market for federal and private loans?

Its major findings include the following:

- Fewer than half of these 58 institutions originated any significant graduate loan volume under their own federal school lender ID prior to Federal Fiscal Year (FFY) 2002. Two of them did so for the first time in FFY 2001. Only nine have been making school-as-lender loans for at least eight years.
- Of the 32 who did not have a program or originate any school-as-lender loans before FFY 2002, eight originated the majority of their federal loans through the Direct Loan program and 24 relied on traditional FFELP lenders.
- Thirteen of the 32 schools that became school lenders in FFY 2002 or 2003 are located in the Midwest, nine in California and other states in the West, five in the Northeast, and five in the South.
- The nine oldest school-as-lender institutions have considerably larger graduate and professional loan volume on average than the newest schools.
- All of the older school-as-lender institutions are private institutions, but 11 of the 32 newest programs are at public universities.
- Far more institutions with graduate and first-professional programs are technically eligible to become school lenders than are likely to attract much interest from lenders and secondary markets anxious to partner with them to support a school-as-lender program.

-
- Institutions must generally meet three threshold requirements if they expect to establish successful, attractive school-as-lender programs:
 - ~ The average borrower indebtedness of their graduate and first-professional students must be high;
 - ~ Their graduate and first-professional borrowers must have an exceptionally low default rate if they expect to receive higher premiums when loans are sold; and
 - ~ The institutions must have a sizeable potential school-as-lender volume.
 - The five most common types of risks posed by a school-as-lender programs are:
 1. Risk of principal loss;
 2. Risk of liquidity;
 3. Administrative risks;
 4. Risk of reputation; and
 5. Regulatory risks.

The first four risks can be minimized if the program is structured properly; the fifth generally cannot. The typical school-as-lender institution relies on a line of credit from its financial partner; contracts with its partner(s) to provide all origination, servicing, and other support; holds the loans only until they are fully disbursed and then sells them promptly for a premium. Consequently, school-as-lender institutions have minimal cost of funds or financial risks, minimal risk of loss from origination or servicing errors, minimal net interest and special allowance earnings, and rely primarily on premium income from loan sales for their program revenues. Regulatory risks, however, are an inherent feature of federal loan programs because fundamental program rules, terms, and conditions can and have been changed at any time through legislation or regulation.

- The two most commonly cited reasons for creating school-as-lender programs are to be able to:
 1. Reduce graduate and professional students' borrowing costs;
 2. Generate revenue to provide institutional grants and scholarships or generate revenue for other institutional purposes.

Differences in institutional characteristics and motives have an effect on the structure of school-as-lender programs and the benefits they provide graduate borrowers and/or other students.

- Borrower benefits at some, but certainly not most, institutions with school-as-lender programs are better than those generally available to graduate borrowers at institutions without such programs. Nevertheless, borrower benefits at some school-as-lender institutions are not competitive. Borrowers who receive the best benefits generally attend institutions whose primary purpose in establishing a school-as-lender program is to reduce their graduate students' cost of borrowing. Those who receive non-competitive benefits are more likely to attend institutions more interested in using the proceeds of their programs to provide financial aid to different students or for other institutional purposes.

-
- The vast majority of institutions with school-as-lender programs attempt to maximize their graduate students' use of the program for their federal borrowing and rarely include other FFELP lenders on a preferred lender list. Many are conscientious about avoiding even the appearance of a conflict of interest by not interfering with their students' ability to take advantage of other loans if they have more favorable terms, but those institutions with non-competitive school-as-lender programs are often the least likely to do so.
 - Very few of these institutions have close links between their school-as-lender program for FFELP lending and private loans their graduate and first-professional students may need. Only half of those interviewed said their line-of-credit provider also provided private loans for their borrowers, yet even in most of these cases, the institutions also relied on other private lenders as well.
 - There is no automatic right answer as to whether an institution should become a school lender to its graduate students. The balance between advantages and disadvantages of such a move varies from institution to institution depending upon its goals, its distinctive institutional characteristics and circumstances, and the current federal and private lending arrangements for its graduate and first-professional students.

Introduction

A sluggish economy, pressure on state and institutional budgets, heavy reliance by graduate and first-professional students on borrowing to help pay for their education, concerns about affordable and manageable debt burdens, lenders' interest in increasing their loan volume or protecting existing market shares, and institutional interest in generating new sources of revenue have all played a role in making school-as-lender programs attractive to a growing number of institutions and to some lenders and secondary markets. The authority for schools to participate in the Federal Family Education Loan Program (FFELP) as lenders to their graduate and first-professional students has a long history but very few institutions chose to do so until recently. Although the 58 institutions identified by this study as school lenders as of September 30, 2003, represent only a tiny fraction of all institutions with sizeable graduate programs, the particular institutions involved and the more than doubling of their numbers in the past two years understandably generates considerable interest.

This report analyzes the full range of issues surrounding the school-as-lender model. The research for it began in late 2002 and was completed in 2004. The report seeks to answer three crucial questions:

- What are the reasons for the recent growth in school-as-lender programs?
- What do institutions with graduate and first-professional programs need to know about the pros and cons of this lending model?
- What impact will these changes have on the market for federal and private loans?

Background

The Higher Education Act (CFR34, Title IV, Section 682.601) permits colleges and universities to be lenders of Federal Family Education Loans (FFEL) to graduate students, provided that the institution is not a correspondence school and does not have a cohort default rate greater than 15 percent for the past two years. The law permitting schools to be lenders was intended originally to assist institutions that were having difficulty finding commercial lenders to serve their graduate students in the early days of the federal guaranteed student loan program. Loan access was not perceived as being as big a problem for the few undergraduates who then borrowed, so the legislation stated that school-as-lender loans could only be made to undergraduates if traditional lenders refused to serve them and even then to not more than half of a school's undergraduates.

Access to loans, however, was never an important consideration for the first institutions that became school lenders. Most were selective, prestigious universities with one or more first-professional schools. Much of the current interest stems from marketing efforts by some members of the student loan industry stressing the revenue opportunities of school-as-lender programs and the ways they can assist schools with the capital, origination, secondary market, and servicing requirements for such a venture. More schools looking to generate new revenue for institutional use from an activity in which they are already engaged — student loans — are now listening.

Institutions identified as currently having a school-as-lender program

The November 2002 issue of the *Greentree Gazette* listed 38 institutions that were acting as FFELP lenders originating Stafford loans and noted that 11 of them were “new” in 2002-03 or “finalizing the process.” Three have still not done so, and one institution that had an active program in FFY 2001 has had no school-as-lender volume for the last two years. Six other institutions were identified subsequently as having started school-as-lender programs by FFY 2002 and 17 more were identified as school lenders by FFY 2003 — bringing the total to at least 58 institutions as of September 30, 2003.¹

- Fewer than half of these 58 institutions originated any significant graduate and first-professional loan volume under their own federal school lender ID prior to FFY 2002. Two of them did so for the first time in FFY 2001. Only nine have been making school-as-lender loans for at least eight years.
- Of the 32 who did not have a program or originate any school-as-lender loans before FFY 2002, eight originated the majority of their federal loans through the Direct Loan program and 24 relied on traditional FFELP lenders.
- Thirteen of the 32 schools that became school lenders in FFY 2002 or 2003 are located in the Midwest, nine in California and other states in the West, five in the Northeast, and five in the South.
- The nine oldest school-as-lender institutions have considerably larger graduate and professional loan volume on average than the newest schools — \$93.2 million (or \$52.0 million excluding the huge Nova Southeastern program) in FFY 2003 compared to \$12.4 million for the 29 newest schools with active programs.
- Only one of the oldest school-as-lender schools has graduate and professional loan volume of less than \$20 million, and over half of them have more than \$50 million in volume each. Among the 32 newest schools, 17 have annual graduate loan volume of less than \$20 million, and eight have loan volume of \$50 million or more.

¹ See Appendix A for a complete listing of these institutions and some other selected characteristics.

- All of the oldest school-as-lender schools are private colleges or universities — six are doctoral/research universities with one or more first-professional schools, two are not research universities but have law schools and other graduate programs, and one is a school of osteopathic medicine. In fact, all of the oldest school-as-lender institutions have at least one first-professional school.
- Eleven of the 32 newest school-as-lender institutions are public universities — 13 of the 32 are doctoral/research universities, but 10 others offer PhDs or are Master’s colleges, six are chiropractic schools, one is a medical school, one a school of optometry, and one a college of podiatry.

Causes of the recent increased interest in school-as-lender programs

Current economic conditions, state budget cuts, reductions in endowment earnings or even losses, and the search for new sources of revenue clearly are the most significant factors in the recent upsurge of institutional interest in school-as-lender programs. The marketing of such programs by some in the student loan industry has played a part too, but these efforts would not have found such a receptive audience had not budgetary pressures on institutions been so great. All the schools that were interviewed that had established programs in the last couple years mentioned “generating revenue to provide institutional grants, scholarships, or other aid” as their primary reason for doing so. Some of the new school-as-lender institutions mentioned it as the only reason for shifting to the new model; others cited additional factors as well.

Institutions that have had programs for a number of years were far more likely to cite other key factors or considerations behind their decision. These included the desire to simplify the FFELP program for their borrowers by reducing the number of lenders, to establish greater institutional control in the loan process, to help assure excellent service for and responsiveness to their borrowers, to make loans faster, and to reduce borrowers’ costs, as well as to generate additional revenue for institutional aid. For them, school-as-lender promised all these benefits and an opportunity to establish an institutionally branded loan program. With so many of their graduate and first-professional students dependent on loans to pay for their education, it provided the institution with a higher degree of quality assurance over the process and greater benefits for their borrowers, which, it was hoped, would carry over into their becoming a large group of supportive, satisfied alumni.

Among the newer schools interviewed, those most likely to mention gaining greater institutional control over loan processing as an important goal were former Direct Loan institutions that switched to FFELP to establish a school-as-lender program. For them, the new model offered a single loan provider, responsiveness to borrowers, prompt loan delivery, and institutional control over the process that they had hoped to achieve originally with Direct Lending. They now saw in their school-as-lender program a way to achieve those goals while at the same time generating net revenues they could use to reduce borrower costs and/or provide additional institutional aid.

Furthermore, some institutions that previously rejected or ignored the school-as-lender model have been prompted to reevaluate the option because of the sluggish economy and state and institutional budgetary pressures. Yet, if current economic conditions and aggressive marketing have helped fuel the recent proliferation of school-as-lender programs, eventual improvements in the economy may not slow their future growth and development. That is because the recent economic crisis prompted many states to fundamentally alter their financial commitment to, and their level of support for, public higher education. Even if some of those pressures ease when the economy improves, states may not return to the levels of financial support they historically provided.

Institutional Eligibility

Eligibility requirements to become a FFELP school lender

The federal eligibility requirements for becoming a school lender in the FFELP program are provided in the Higher Education Act (Section 435(d)(2) through (d)(5); Title IV Regulations (CFR34, Section 682.601); and US Code (20USC1085). Essentially, they indicate that to be eligible, a school:

- Must employ at least one person whose full-time responsibilities are limited to the administration of its Student Financial Assistance programs;
- Must not be a correspondence school;
- Must not make FFELP loans to undergraduates unless the borrower has been previously denied a loan by an eligible FFELP lender;
- Must not have a FFELP cohort default rate greater than 15 percent for the two most recent federal fiscal years;
- Must use the proceeds from its interest and special allowance payments for need-based grants, except for reimbursement of reasonable direct administrative expenses; and
- Can make FFELP loans to any and all of its eligible graduate and first-professional students.

Process to become a FFELP school lender

There are a number of steps involved in establishing a school-as-lender program once the decision has been made to do so. Not all current school-as-lender institutions followed all of them, but most of those interviewed said they wish they had. These include:

- **Do your homework.** Implementing a successful program requires a tremendous amount of work in advance, and there are few reliable shortcuts.
 - ~ Review federal statutes and applicable regulations to determine what is required;
 - ~ Check state law and requirements on incurring debt or holding loans, especially if you are a public institution;
 - ~ Review bond issues and insurance policies to make certain that incurring additional debt will not violate those agreements;
 - ~ Review school-as-lender programs at other institutions to determine what is possible and what pitfalls to avoid; and
 - ~ Get all parties at your institution that would be affected — financial aid, bursar, treasurer, other financial decision makers, legal counsel, and deans of individual graduate and professional schools — together to focus on overall program objectives and structure, desired service levels, and potential benefits.

-
- **Determine procurement strategy and requirements.** Many of the institutions with older school lending programs relied on a more informal process because there were fewer potential partners and fewer examples to follow. Simply accepting a proposal when approached by a student loan industry member marketing a school-as-lender program or informally soliciting proposals from just a few potential providers can produce results that prove to be less satisfactory later.

Most institutions that were interviewed for this research agree that the best method is to disseminate program specifications widely through a more formal procurement, such as issuing a Request for Proposals (RFP). It may take longer to develop, but it is more likely to reflect a broad consensus within the institution on desired program components and provide a more reliable basis for evaluating the different offers received. Even then, not all prospective school-as-lender bidders have experience working with or lending to graduate and first-professional student borrowers, so failing to establish experience requirements for potential school-as-lender providers can cause problems later.

- **Select finalists and review prospective contracts.** It is important to make sure they clearly cover line-of-credit funding provisions and costs; loan origination and servicing contract responsibilities and liabilities; guarantor; accounting, record keeping, and reporting; sales timing, method for determining premiums and purchase prices; implementation time lines, contract length, and renewal provisions; and other contract details.
- **Review “best and final offers” and select school-as-lender partner(s).**
- **Obtain a lender ID from the Department of Education.**
- **Implement the program.**

The Structure of School-As-Lender Programs

Sources of funding, origination, servicing, purchasing, and other support functions

Currently there are almost as many companies trying to market school-as-lender programs and services to institutions as there are actually providing support to school-as-lender programs. That support ranges from offering lines of credit to fund school-as-lender loans; to providing origination, guarantee, and servicing functions; to serving as secondary markets with commitments to purchase school-as-lender loans at a premium; to assisting institutions with the RFP process, proposal evaluation, and/or advice on portfolio valuation.

- Only a few of the 58 institutions with school-as-lender programs self-fund the loans they make to their students using their own resources. All of the rest rely on commercial lenders or secondary markets to provide a line of credit to finance their loans. This is particularly true of the newest school-as-lender participants, because very few of them seem interested in using their own institutional funds or incurring a significant negative cash flow to finance a program.
- In rare instances, the FFELP lender providing the line of credit is different from the secondary market purchasing the school-as-lender loans, but in most cases the line of credit provider and the secondary market are one and the same.
- The line of credit and/or secondary market providers have been identified at many of the school-as-lender institutions, including five instances where there are two providers. The lender with the most institutions was Sallie Mae, followed by Illinois Designated Account Purchase Program (IDAPP), Citibank, Nelnet, Bank of America, Oklahoma Student Loan Authority (OSLA), Educaid/Wachovia, Grad Partners, and other lenders with one institution each.
- Nearly one-third of current school-as-lender institutions use line of credit and/or secondary market providers that are state or regional secondary markets. These providers appear to be marketing the programs as a way to increase both the size of their portfolios and the predictability of their annual loan purchases. They include Brazos (Texas), CSOBA (Colorado), IDAPP (Illinois), MHELSEA (Michigan), OSLA (Oklahoma), PHEAA (Pennsylvania), and NTHEA (Texas).
- All school-as-lender institutions eventually sell their loans to secondary markets, and almost all of them sell the loans immediately after they are fully disbursed. Very few institutions continue to hold their loans until their borrowers begin the grace period prior to entering repayment.
- Virtually all school-as-lender institutions contract with student loan industry partners to provide origination and servicing support. Contracting out these functions simplifies the administrative requirements for establishing a program and largely eliminates a potential source of risk. These costs are normally included as part of the purchase contracts, but in at least one case in which the institution self-funds its school-as-lender loans, it pays a fee for every single loan originated for them.
- Most institutions contract with a single entity to provide a line of credit, a secondary market, and all origination, accounting, and servicing functions. Others schools contract with multiple companies that have agreed to partner to provide funding and the other functions required by a particular school-as-lender institution.

Potential Benefits to Institutions

Revenue sources for institutions with school-as-lender programs

School lenders as well as traditional lenders in the FFEL program typically generate three types of revenue:

- **Interest Payments.** FFELP lenders receive interest income from the federal government on subsidized student loans during the in-school and grace period when borrowers are not required to pay interest themselves. They also receive accrued interest on unsubsidized loans from secondary markets at the point the loan is sold if that takes place prior to the borrower entering repayment. Because most institutions with school-as-lender programs sell their loans each year soon after they are fully disbursed, the amount they receive in interest payments is small. If they are fortunate, the interest payments are enough to cover most, if not all, of the cost of funds or interest on their line of credit and other direct administrative costs.
- **Special Allowance Payments.** These are made by the federal government only in the event that the cost of funds and the permitted yield on FFELP loans exceeds the statutory cap for interest that can be charged to borrowers, based on a formula specified in statute. In recent years, special allowance payments have been rare. In any event, schools must use any revenue they receive from interest or special allowance payments for need-based grants and/or to cover “reasonable expenses” directly related to the administration of FFELP.
- **Premium Income.** School lenders all sell their loans at some point to secondary markets and receive a premium (a price higher than the loan principal on all loans plus any accrued interest owed by the borrower on unsubsidized loans at the time of sale). The premium a secondary market will pay for school-as-lender loans depends on a number of factors, including:
 1. How long the school holds the loans prior to sale;
 2. The average borrower indebtedness (ABI) of loans in the sale;
 3. The likelihood of delinquency or default among the school’s graduate borrowers; and
 4. The likelihood the borrowers will consolidate their loans prior to commencing repayment.

However, the actual premium revenue a school receives and the net premium income it will have for other institutional purposes are not the same. Unlike interest and special allowance revenues, there are no restrictions on how a school uses the premium income it receives from the sale of its loans.

Amount and uses of new institutional revenues

As noted earlier, the three primary sources of revenue for school-as-lender institutions are interest, special allowance payments and premium income.

- Except for the very few institutions that hold their school-as-lender loans throughout the in-school period, interest and special allowance payments from the federal government are minimal — rarely sufficient to fully offset

the cost of funds on their line of credit, any origination and servicing costs, and the 0.5 percent lender origination fee they owe to the federal government.

- Consequently, premium income is normally the largest and most significant source of revenue for institutions with school-as-lender programs. Premiums of 3 to 6 percent are possible, and could generate gross revenues of \$300,000 to \$600,000 annually on a \$10 million portfolio of new loans, but the net revenue would be considerably less. Actual premiums vary depending upon a variety of portfolio characteristics and annual gross premium income depends on those characteristics and the institution's annual school-as-lender volume. Precise information was difficult to obtain. Every school interviewed expressed general satisfaction with the premium income they received and none would disclose what it was.
- The amount of net revenues an institution has for other purposes, however, depends on its gross premium income and on the level of front- and/or back-end benefits it wants its borrowers to receive.
 - ~ Institutions that want to eliminate guarantee and origination fees for their borrowers or provide them with anything more than the standard back-end benefits their secondary market offers all borrowers cannot afford to do so if their gross premium is less than 3 percent.
 - ~ Even those institutions receiving premiums of 3 or 4 percent will have little left for any other purposes if they buy down or eliminate their borrowers' origination fees.
 - ~ Of course, institutions with very high average borrower indebtedness, substantial annual school-as-lender volume, and exceptionally low borrower default rates can sometimes command higher premiums, provide substantial front- and back-end borrower benefits, and potentially have substantial amounts left for institutional grants and fellowships or for other purposes.

Potential Benefits to Students

Which students receive school-as-lender benefits? What form do they take?

There are two general patterns and a considerable range of variation in between:

- Graduate and first-professional student borrowers at institutions with school-as-lender programs that provide origination fee discounts or rebates are the primary beneficiaries of the program revenues they help to generate. These discounts can mean \$300 to \$550 or more each year for graduate or first-professional students borrowing the maximum allowable amount of federal loans. The savings can be even greater for medical student borrowers.
- Institutions that do not offer borrowers fee discounts or other borrower benefits often use their net school-as-lender revenues to provide institutional grants or scholarships to a more limited number of students. These funds may be targeted toward particularly needy borrowers. Many institutions, however, use the revenues from their school-as-lender programs to further enrollment management objectives that do not necessarily benefit graduate borrowers. Although some distribute funds to deans at the graduate and professional schools whose student borrowers helped generate them to use as they see fit, a greater percentage augment grant resources for undergraduate students. While the net revenues from school-as-lender programs can be considerable at some institutions, making sizeable grant or fellowship awards from them necessitates targeting those awards to a much more limited number of recipients.
- Net revenues derived from interest and special allowance payments after paying for the cost of funds, the lender origination fee, and direct administrative costs must be used for need-based grants. Those derived from premium income can be used for any purpose, and school-as-lender borrowers are often, but not always, the beneficiaries. It depends on their institution's objectives in establishing a program.

How competitive are borrower benefits in school-as-lender programs?

Answering this question requires a comparison between the front-end and back-end borrower benefits in school-as-lender programs and those that FFELP borrowers at other graduate and professional schools may receive.

Front-end borrower benefits

- There are two types of front-end borrower benefits that some, but certainly not all, graduate student borrowers receive from institutions with school-as-lender programs: (1) reduction or elimination of the one percent guarantee fee; and/or (2) reduction or elimination of the three percent loan origination fee.
- ~ **Guarantee Fees.** Guarantors in the FFELP are authorized to charge borrowers up to one percent of the amount of the loan as a guarantee fee. Until 2004, most large guaranty agencies charged all their federal borrowers a zero percent guarantee fee. In most instances, the guaranty agencies simply forego the revenue the fee would produce to remain competitive. In some cases, guaranty agencies with affiliated state-designated secondary markets have the fee paid for the borrower by the secondary market. Only three instances were uncovered of school-as-lender institutions whose borrowers were charged up to one percent for a guarantee fee and one other institution whose graduate borrowers were charged the full one percent.

In every other case, borrowers at school-as-lender institutions were charged a zero percent guarantee fee — no more and no less than FFELP borrowers at other schools using the same guarantor.

That pattern has changed. USA Group, the nation's largest guarantor, began charging a 0.5 percent guarantee fee in April 2004. If other guarantors were to follow, this could eliminate this benefit for borrowers at school-as-lender institutions and other FFELP schools.

- ~ **Origination Fees.** Lenders can charge FFELP borrowers up to three percent of the principal amount of the loan as an origination fee. Whatever they charge the borrower, lenders must pay the full three percent to the federal government. To the extent that institutions with school-as-lender programs want to make sure their program is better than, or at least competitive with, what their borrowers would receive from traditional FFELP lenders, many school-as-lender institutions often discount some, if not all, of the three percent origination fee for their graduate and professional borrowers. Those that do so normally pay for that benefit directly or indirectly from premium income they receive (or forego) when the loans are sold.

About half of the school-as-lender institutions charged their graduate borrowers a zero origination fee or rebated the full fee amount to them. In contrast, some others charged one to two percent, a few charged varying amounts up to three percent, and a sizeable number of others charged their school-as-lender borrowers the full three percent origination fee. (See Appendix B for a summary of the questions asked school-as-lender institutions).

Differences in average borrower indebtedness and in delinquency and default rates are probably factors, but the primary differentiation between school-as-lender institutions whose borrowers pay zero net origination fee from those whose borrowers pay the full three percent is the different choices the institutions make about how to use their program revenues. It does not appear to be the size of their graduate and first-professional enrollments, their average graduate and professional loan volume, or whether they have first-professional schools or other programs where students have high average borrower indebtedness that distinguishes the two groups of schools. **Those institutions whose school-as-lender borrowers pay zero net origination fees seem to be most interested in using the revenue from the school-as-lender program to reduce their graduate students' cost of borrowing while those schools whose students pay the full fee appear to be more interested in using the proceeds of their program to provide financial aid to different students or for other institutional purposes.**

In some cases, full or partial origination fee discounts are available to first-professional students from traditional FFELP lenders. When they are, they can be as good as those available to borrowers at institutions that charge a zero fee and clearly better than those available to graduate borrowers at institutions that charge a three percent origination fee in their school-as-lender programs.

Back-end borrower benefits

- There are fewer differences in the benefits borrowers in school-as-lender and regular FFELP programs receive once they enter repayment.
- ~ Most traditional FFELP lenders and secondary markets provide back-end borrower benefits as well, including interest-rate reductions for borrowers who demonstrate they consistently repay their loans in a timely fashion and a more modest reduction (usually 0.25 percent) for borrowers who agree to have their monthly payments automatically deducted from their bank account. These benefits are often available to borrowers at institutions with school-as-lender programs as well as to those who borrow from traditional lenders at other FFELP schools.

-
- ~ Occasionally, school-as-lender programs provide their borrowers with superior back-end benefits: at one institution, its school-as-lender borrowers' interest rates are reduced by two percentage points immediately upon entering repayment; at another, school-as-lender borrowers receive a one percentage point reduction after 12 months of on-time payments and an additional one percentage point after 24 months, instead of the more common two percentage points after 48 months; still others provide one or two percentage point reductions after 36 months; and one institution announced that its school-as-lender borrowers would be charged no interest after making 36 months of on-time payments. These are clearly the exceptions, however. In most instances, if school-as-lender borrowers receive back-end benefits, they receive the same standard benefits provided to other borrowers whose loans have been sold to the same secondary markets.
 - The possibility of securing substantial new federal undergraduate as well as graduate volume may make Direct Loan institutions particularly attractive candidates for a school-as-lender conversion. Although in one case, only the graduate and professional schools are leaving Direct Lending for FFELP, several other school-as-lender institutions have no undergraduate volume, and at a few others the graduate volume dwarfs the undergraduate federal volume.
 - Furthermore, no evidence was uncovered to suggest that at institutions with large undergraduate loan volume, school-as-lender pricing and borrower benefits were structured as loss leaders to try to capture federal undergraduate volume. As the loan volume figures in Appendix A show, there were eight public and one private school-as-lender institutions that had substantially larger undergraduate than graduate loan volumes, and few of them were among the school-as-lender institutions with the best graduate and professional borrower benefits. Moreover, 17 school-as-lender institutions have no appreciable undergraduate volume. However, there are a few other school-as-lender institutions where the graduate volume was four or five times greater than the undergraduate volume; their school-as-lender volume ranged from \$50 to \$90 million, and enabled them to provide the best borrower benefits on school-as-lender loans. Several were also able to leverage zero fees on private loans and produced sufficient net revenues to extend benefits to their undergraduate borrowers as well.

Potential Risks to Institutions

There are five types of risk that a school-as-lender program could pose to an institution: (1) risk of principal loss; (2) risk of liquidity; (3) administrative risks; (4) risk of reputation; and (5) regulatory risk. The potential each poses has often been raised, but rarely assessed carefully. Moreover, there are steps that can be taken to minimize the first four types, but not the fifth.

- **Risk of Principal Loss.** The potential risk of principal loss normally stems from two types of problems — origination errors or improper servicing. If a school handles the loan origination process itself, it is responsible to the Department of Education for errors, but most institutions with school-as-lender programs contract out the origination function and thereby shift the financial responsibility for any origination errors to their contractor and the guarantor. Improper servicing that could result in the loss of the guarantee on a subsequently delinquent and defaulted loan is most likely to occur, if it occurs at all, during or following a borrower's conversion to repayment. That risk is virtually eliminated for most school-as-lender institutions because of the timing of their sale of these loans — soon after they are fully disbursed and well before they enter repayment. Moreover, their program partners normally provide in-school servicing under contract. This means the contractor, not the school, is fully responsible for any origination or servicing problems. Even the few institutions that hold their school-as-lender loans until their borrowers' grace period — far longer than most school-as-lender programs — have never had a single dollar of principal loss. Finally, the low default rates at virtually all schools with school-as-lender programs make the risk of principal loss from servicing errors miniscule for the secondary market purchasers, even during the repayment period.
- **Risk of Liquidity.** The risk of liquidity is minimal for most school-as-lender institutions because they normally sell their loans soon after they are fully disbursed — within five to seven months. Nonetheless, the risk of liquidity requires institutions with school lending programs to carefully assess the financial capability of their secondary market partners and their partners' ability to fully meet the timing and terms of the loan purchase contracts.
- **Administrative Risk.** Most school-as-lender programs do not take a lot of administration to implement. For the most part, school-as-lender programs build on existing software and electronic capabilities and the institutions' responsibilities are little different from what they would be if they chose to participate in the Stafford loan programs in a conventional manner. They must be prepared to properly certify loans; monitor loan originations, sales, and fund transfers; perform some reconciliation work or oversight; and monitor contract compliance and performance by their school-as-lender partners. Probably the greatest administrative risk posed by these programs occurs when insufficient attention is paid in advance to the detailed terms, conditions, and liability provisions in the contracts with their school-as-lender partners.
- **Risk of Reputation.** The desire to maximize revenue by promoting the institution's school-as-lender program and the responsibility to make sure borrowers are fully informed about which lender best meets their financial needs creates a potential conflict of interest for institutions with school-as-lender programs. This is most likely to occur when an institution's school-as-lender program is the only lender listed and does not provide competitive borrower benefits. When that happens, or when students are pressured to use the institution's program rather than attracted to it because of superior benefits, the resulting conflict of interest can produce tensions within the institution and do a disservice to its graduate student borrowers. Many school-as-lender institutions are conscious of the potential conflict and take steps to avoid it either by making sure their program is competitive, by listing other preferred lenders in addition to the school, and/or by making sure they do nothing to prevent

their students from taking advantage of a better offer if they can find one. As one executive at a school-as-lender institution observed, “Anyone considering a school-as-lender program must make sure that their program is fair to their students in terms of the benefits it provides. Sacrificing fairness jeopardizes the institution’s reputation and that loss is hardly worth a few extra bucks for the school’s benefit.”

- **Regulatory Risk.** All of the fundamental terms and conditions of lender participation in the FFEL program — interest rates, special allowance rates, lender origination fee levels, lender margins, percentage of principal and accrued interest paid on lender claims, due diligence requirements and penalties, loan consolidation provisions, etc. — are subject to change at any time through either legislative action or regulatory change. On several occasions in the past, Congress has reduced lender yields and added new administrative requirements to try to generate budget savings for the federal government. With the reauthorization of the Higher Education Act scheduled for the coming year and sizeable federal deficits looming, program terms could change again. Any reduction in lender yield would affect all FFELP lenders and secondary markets, including school-as-lender institutions, either directly or indirectly.

Institutions That Might Benefit from a School-As-Lender Program

The simple fact is that there are far more institutions with graduate and first-professional programs “eligible” to become school lenders than there are institutions that are likely to attract much interest from lenders and secondary markets eager to partner with them to support a program. There are at least three threshold requirements an institution generally must meet if it expects to establish a successful, attractive school-as-lender program:

- **The average borrower indebtedness (ABI) of its prospective graduate and first-professional participants must be high.**

Generally this requires the institution to have at least one first-professional school participating, because most professional students borrow and they often borrow the maximum allowable amount on their federal loans each year — \$18,500 for most law and dental students and even higher for medical students at schools that used to participate in the HEAL program. Institutions with large numbers of Master’s and PhD student borrowers and few professional school borrowers would not likely attract much lender interest or a very high loan premium.

- **The institution’s graduate and first professional borrowers must have a low default rate.**

Although institutions with default rates of less than 15 percent are technically eligible, any institution where graduate and professional students have a default rate of two percent or higher will find it difficult to start a successful school-as-lender program and receive high premiums when loans are sold. Although some school lenders currently do not have exceptionally low default rates, those rates affect their portfolio value and program revenues. Institutions with the lowest default rates are far more likely to attract prospective industry partners who are willing to pay a sizeable premium for their school-as-lender loans.

- **The institution must have sufficient potential school-as-lender volume.**

~ Most knowledgeable school-as-lender partners place the critical volume threshold at \$10 million or more a year. There are six recent school-as-lender institutions with annual graduate loan volume of less than that, but two are small podiatric colleges whose students have ABIs of \$10,000 to \$20,000 a year and two had programs that were not yet active in FFY 2003; it is too early to tell how attractive or long-lived the programs at these six institutions will be.

~ Six other institutions with school-as-lender programs that began in FFY 2001 or earlier have annual graduate or professional loan volume of between \$10 and \$20 million. None had a volume under \$10 million and the average was over \$41 million. However, four of them had annual school-as-lender volume of less than \$10 million (out of total graduate/professional volumes of \$13, \$26, \$56, and \$65 million). The smallest of these institutions appears to have terminated its school lending in FFY 2003, and a second institution believes its program could be in trouble because its benefits are not competitive with those offered its students by traditional FFELP lenders.

Institutions whose graduate and especially first-professional students meet the first two threshold requirements and that have annual potential school-as-lender volumes of \$20, \$30, or \$40 million or more are far more likely to attract industry partners and succeed.

Characteristics of Current School-As-Lender Institutions

Although there are often considerable differences among them, the typical school-as-lender institution possesses the following characteristics:

- The typical institution with a school-as-lender program has nearly 4,500 graduate and first-professional students and an average total enrollment of 11,600. They range in size from 291 to over 15,000 graduate and professional students. Except for the chiropractic, optometric, podiatric, and other allied health institutions, none of the other school-as-lender institutions have graduate enrollments of less than 1,000.
- The typical school-as-lender institution has a graduate loan volume of \$41.9 million in FFY 2003, although the average for the newest schools is lower — \$29.9 million. The volume at school-as-lender schools ranges from just \$1.7 million to almost \$375 million dollars: institutions with older programs average \$41 million in school-as-lender loans, newer schools that have actually begun making school-as-lender loans average \$12.4 million so far.
- Nearly 78 percent of all school-as-lender institutions are private colleges and universities, although 13 institutions with programs, including 11 of the newest ones, are public universities.
- Virtually all institutions with school-as-lender programs have at least one, if not more, first-professional schools.
- The typical school-as-lender institution relies on a line of credit from its program partners to fund the loans; contracts with its partners to provide all origination, servicing and other support; and holds the loans only until they are fully disbursed and then sells them promptly for a premium. Consequently, it has minimal cost of funds or financial risks, minimal net interest and special allowance earnings, and relies primarily on premium income for whatever benefits it provides to borrowers or other students.
- There are very few institutions that self-fund their school-as-lender programs from their own resources and fewer still that hold the loans throughout the in-school period before selling them.
- There are substantial differences in the size of school-as-lender programs, in the range and scale of benefits they provide, in the ways they use their program revenues, and in their original objectives for creating a program. However, there are far fewer differences among them in the way the programs are funded, how they are administered, or when the loans are sold. Although these differences are important, they do not constitute distinctively different school-as-lender models.

Extent of current borrower choice of lender at school-as-lender institutions

Almost all the institutions that have school-as-lender programs originally intended to phase in the new program by making school-as-lender loans to new, first-time borrowers, but not all were able to do so. In many instances,

the programs evolved faster or in ways that were not always anticipated originally; in others they have grown more slowly. For example:

- New school-as-lender institutions with significant borrower benefits (particularly a zero origination fee) that originally intended to phase in the program sometimes faced demands from continuing graduate students that they be allowed to switch immediately to take advantage of the greater savings. In a few instances, particularly at institutions with medical schools or medically related training programs where the annual savings amounted to \$550 or more and where most borrowers consolidated their loans upon entering repayment, the institutions ended up converting almost immediately whether they originally planned to do so or not. When 90 percent or more of their borrowers moved to the new program, they simply stopped using a preferred lender list. Nevertheless, in over 60 percent of the cases, the school-as-lender program was phased in and the institution was listed as one of several lenders (often the first listed) on a preferred lender list.
- Some new school-as-lender institutions attempted to rely exclusively on school-as-lender for their federal lending as soon as possible because of their desire to maximize program revenues quickly. They were not always successful, however.
- At other institutions, the school-as-lender program is used exclusively for lending to students at participating graduate or first-professional schools but other professional schools did not participate and continue to use a broader preferred lender list. For example, in at least one case, the law school does not yet participate in the new school-as-lender program although some of the law students are pressuring the school to join. At another university, graduate students in Master's and PhD programs participated for years in its school-as-lender program before the medical school joined in FFY 2002 and the law school in FFY 2003. Before they joined, they had their own preferred lender lists.
- Institutions that have school-as-lender programs that do not yet have all their first-professional schools participating are likely to exert increasing pressure on them to do so. The higher ABIs of first-professional borrowers would likely raise the average for the entire program and could increase the loan premium paid when the loans are sold. That, combined with the larger loan volume in an expanded school-as-lender program, would increase program revenues and could improve benefits for all participants.
- On the other hand, first-professional schools whose borrowers are receiving discounted fees and other benefits from traditional FFELP lenders may resist incorporation into their institution's school-as-lender program if the resulting portfolio would be less attractive and net benefits for their borrowers would go down. This is part of the explanation for the problems at least one institution has experienced in trying to expand participation in its program without forcing professional students to do so.
- Likewise first-professional schools with their own school-as-lender programs are likely to resist requests for inclusion by their institution's other graduate schools if that would result in reduced benefits for their own borrowers or lower net revenues for their school-as-lender program.

Relationship between federal and private loans at current school-as-lender institutions

At most institutions, the federal school-as-lender loans and private loans their students receive are kept separate and distinct. For example:

- One of the institutions that self-funds its program and eventually sells those loans to a secondary market relies primarily on another lender's private loans for its professional students who need them.
- Two school-as-lender institutions rely on one lender as their line of credit provider, but their students rarely use that lender's private loan program and receive most of those loans from different lenders.
- Yet another institution thinks the private loan program offered by its line of credit/secondary market partner is too expensive so it uses a different private lender instead. It gives its graduate and first professional students one choice of lender for their federal school-as-lender loans. FFELP regulations prohibit an institution from refusing to process a loan made by an eligible federal lender when requested by an eligible student, but some institutions adopt procedures that limit choice. This same institution gives its graduate students a single, but very different, choice of lender for their private loans.
- In still other cases, school-as-lender institutions rely on different federal and private loan providers because their program partners do not have a private loan program. In those and most other instances, the school-as-lender and private loans are made and serviced separately even though most institutions concede that it would be an advantage to their borrowers if both loans came from or were sold to the same source and could be serviced together.

Interviews uncovered very few instances where there was a close linkage between federal and private loans at institutions with school-as-lender programs.

- For example, one of the early school lender's primary motives for creating its school-as-lender program was to use it to leverage greater benefits and reduce costs for its private loan borrowers because most of its graduate and first-professional students relied on both types of loans. Consequently, its letter of credit provider and secondary market provide both loans. They are offered to borrowers with no fees, accelerated back-end borrower benefits, life-of-loan servicing, and combined billing on their federal and private loans.
- At another more recent participant, its federal and private loan programs are also closely linked with borrower benefits, zero fees, and combined billing for both. Bidders on its RFP were required to specify not only line of credit and loan premium terms, borrower benefits, and terms for a host of other required services but also their credit approval criteria for private loans and to extend loan eligibility for certain graduate students with reduced credit hours. At the same time, the institution uses other private loan providers as well when students request them.

In any event, establishing a school-as-lender program could have an impact on the institution's relationship with its private loan provider(s). Higher-priced institutions with first-professional schools whose students rely heavily on both federal and private loans will need to maintain a solid relationship with at least one private lender. Even if they maintain the relationship with their current private lender, the loss of federal loan volume could affect private loan pricing or other services provided by that lender.

Possible role of “opportunity funds” at some institutions

There has been considerable discussion recently about so-called “opportunity funds” and their potential role in influencing institutions’ or borrowers’ decisions on their loan providers. The Higher Education Act prohibits lenders from “offering, directly or indirectly, points, premiums, payments, or other inducements to any educational institution or individual to secure applicants” for federal loans. The statutory prohibition does not deal specifically with private loans, however.

Most of the institutions interviewed stated emphatically that they did not receive any opportunity funds. To the extent that a pattern could be discerned, it appears that industry concerns and suspicions about opportunity funds are most closely linked to one major lender and the possible ties between its “Opportunity Loan Program” and its private loan program. *The Chronicle of Higher Education* reported allegations that one Direct Loan institution was offered \$4 million in private “opportunity” loans for its students who had past credit problems and would not ordinarily be eligible for a private loan. In exchange, the institution was expected to drop out of the federal Direct Loan program and instead make this FFELP lender the “exclusive provider” of federal loans on its campus. The institution said it was tempted by the offer, but declined. It now plans to start a school-as-lender program for its graduate students with the same lender as its partner but will keep its undergraduate borrowers in the Direct Loan program. Initially, just two of the seven institutions that were formerly in the Direct Loan program but switched in the past two years to FFELP when they started a school-as-lender program, used this same lender as their program partner. Yet, both former Direct Loan and long-time FFELP institutions that rely on this lender for lines of credit, origination and servicing, secondary market, and other services as their program partner either denied receiving any opportunity funds, cited confidentiality provisions in their contracts, or simply declined to answer.

The Department of Education still has not taken a position on the question of inducements in private loan programs, but some in Congress have warned the student loan industry to reexamine its practices, reach agreement on what constitutes an inducement in federal and private loan programs, and get its house in order or they will pass new legislation to resolve the issue.

Federal loan volume growth in current school-as-lender programs

The 58 institutions that have school-as-lender programs enroll over 221,500 graduate and first-professional students and have a total enrollment of 553,500. The 35 that had active programs in FFY 2002 had a combined graduate loan volume that year of nearly \$1.6 billion. Almost \$1.3 billion of that volume was at institutions that began their school-as-lender programs before FFY 2002; the other \$298 million was at institutions that started a program in 2002. The combined school-as-lender volume of these same 35 institutions that were active in FFY 2002 was over \$970 million, but \$891 million (over 92 percent) of that was at institutions with older programs.

By FFY 2003, however, the 58 institutions now with school-as-lender programs had a combined graduate federal loan volume of over \$2.4 billion. Almost \$1.5 billion was at older school-as-lender institutions and \$955 million at new participants. More significantly still, the total school-as-lender volume at these 58 institutions was now more than \$1.4 billion, an increase of 50 percent. Moreover, school-as-lender volume at the 32 institutions with new programs in 2002 or 2003 more than tripled to \$361 million.

In FFY 2002, the institutions that began a program that year had school-as-lender volume that accounted for just 10 percent of their total graduate and first-professional loan volume. By FFY 2003, however, school-as-lender volume accounted for 38 percent of the total graduate volume at the 32 institutions that began their program that year or in 2002.

If, over the next three or four years, the programs at these 32 institutions are fully phased in and more closely resemble those at institutions with more established programs, then two-thirds or more of the new institutions' total graduate loan volume, on average, will be school-as-lender loans. That alone would increase total school-as-lender volume at schools that already serve as lenders to their students by over \$310 million and bring total federal volume at current school-as-lender institutions to about \$1.8 billion — an increase of an additional 22 percent.

There are currently at least three additional schools that are negotiating with prospective school-as-lender partners or at the RFP stage of school-as-lender procurements. They had a combined graduate and professional loan volume in FFY 2003 of almost \$110 million. There are also at least a dozen others that are examining the implications of moving to a school-as-lender program, although a number of them may never do so. Nevertheless, the combined graduate and professional loan volume at these institutions was more than \$400 million last year. If seven or eight of them were to establish programs and it took two or three years to fully ramp up their school-as-lender program, that could mean an additional \$200 to \$250 million more in school-as-lender loans by 2007.

In the past two years, 32 institutions started programs and it appears that perhaps a dozen more are considering such a move. Even if the pace slows, rather than accelerates, over the next few years, it is quite conceivable that between the institutions that have recently started school-as-lender programs, those that are thinking about doing so, and others that have not yet been heard from, the total additional graduate and first-professional loan volume from school-as-lender programs could grow by \$750 million or more within five years, not counting the \$1.4 billion in school-as-lender volume in FFY 2003 from institutions with new or already established programs. In short, it seems possible that total federal graduate and first-professional loans in school-as-lender programs could increase by 50 percent or more by FFY 2007.

Questions Institutions Need to Answer in Considering a School-As-Lender Program

Some of the points reviewed in this section have been raised earlier in this report but are worth repeating. The first step should be to:

- Determine your institution's objectives for such a program:
 - ~ Are you interested in reducing your graduate borrowers cost of borrowing and ultimately their cumulative indebtedness? If so, determine whether that goal can best be achieved through a school-as-lender program or through continued reliance on traditional FFELP and private lenders.
 - ~ If aiding graduate borrowers is not your goal, what do you plan to do with any additional net revenues a school-as-lender program might produce?
- Conduct a realistic assessment of your institution's likely graduate loan portfolio valuation, potential program revenues, likely program costs, institutional risks, and whether net program revenues will be sufficient to provide competitive borrower benefits or meet other institutional purposes.
- Assess the potential impact of establishing a school-as-lender program for federal borrowing by your graduate students on their access to and costs for loans and other services from your private loan provider(s).
- Determine what policy your institution will follow to avoid the potential conflict of interest posed by school-as-lender programs and assure fair treatment of graduate borrowers and protection of their best interests.

If all your institution's stakeholders can reach agreement on these questions and a decision is made to investigate further, it will be time to:

- Review federal statutes and applicable regulations to determine eligibility and what is required. Be sure to assess possible upcoming changes in federal law that might affect lender yields or increase other regulatory risks.
- Check state law and requirements on incurring debt or holding loans, especially if you are a public institution.
- Review bond issues and insurance policies to make certain that incurring additional debt will not violate those agreements.
- Review school-as-lender programs at other institutions to determine what is possible and what pitfalls to avoid.
- Determine whether to proceed. If you do, develop your procurement strategy and carefully structure your procurement requirements.

Summary

- Current economic conditions, state budget cuts, reductions in endowment earnings or even losses, and the search for new revenue sources have clearly been the most significant factors in the recent upsurge of institutional interest in school-as-lender programs.
- Over half of the 58 identified institutions with school-as-lender programs began their program in just the last two years.
- All of the older school-as-lender programs are at private institutions, but 11 of the 32 newest programs are at public universities.
- Far more institutions with graduate programs are technically eligible to become school lenders that are likely to attract much interest from lenders or secondary markets anxious to partner with them to support a school-as-lender program.
- Institutions must generally meet three threshold requirements if they expect to establish successful school as lender programs with competitive borrower benefits:
 - ~ The average borrower indebtedness of their graduate students must be high;
 - ~ Their graduate borrowers must have an exceptionally low default rate if they expect to receive high premiums when loans are sold; and
 - ~ The institutions must have a critical potential school-as-lender volume.
- The five most common types of risks to institutions posed by school-as-lender programs are:
 - ~ The risk of principle loss,
 - ~ Risk of liquidity,
 - ~ Administrative risks,
 - ~ Risk of reputation from potential conflicts of interest, and
 - ~ Regulatory risks.

The first four can be minimized if the program is structured properly, the fifth generally cannot because of the ease and frequency with which fundamental loan program rules can and have been changed through legislation or regulation.

- The three most commonly cited reasons for creating school-as-lender programs are to be able to:
 - ~ Reduce graduate and first-professional students borrowing costs;

-
- ~ Generate revenue to provide institutional grants and scholarships, often for other students; or
 - ~ Generate revenue for other institutional purposes.
- Borrower benefits at some, but certainly not most, institutions with school-as-lender programs are better than those generally available to graduate borrowers at institutions without such programs. Nevertheless, borrower benefits at some school-as-lender institutions are not competitive. **Borrowers who receive the best benefits generally attend institutions whose primary purpose in establishing a school-as-lender program was to reduce their graduate students' cost of borrowing. Those whose graduate borrowers receive non-competitive or only average benefits are more likely to attend institutions that were more interested in using the proceeds of their programs to provide financial aid to different students or for other institutional purposes.**
 - The vast majority of institutions with school-as-lender programs attempt to maximize their graduate students' use of the program for their federal borrowing and rarely include other FFELP lenders on a preferred lender list. Many are conscientious about avoiding even the appearance of a conflict of interest by not interfering with their students ability to take advantage of other loans if they have more favorable terms, but those institutions with non-competitive school-as-lender programs are often the least likely to do so.
 - Very few of these institutions have close links between their school-as-lender program for FFELP lending and private loans their graduate students may need. Only half of those interviewed said their line-of-credit provider also provided private loans for their borrowers, yet even in most of these cases, the institutions also relied on other private lenders as well.
 - There is no automatic right answer as to whether an institution should become a school lender to its graduate students. The balance between advantages and disadvantages of such a move varies from institution to institution, depending upon its goals, its distinctive characteristics and circumstances, and the current federal and private lending arrangements for its graduate and first-professional students.

Appendix A:

Institutions with School-As-Lender Programs by 2003-04

Institution	New in 2003	FFEL	DL	FFY 2003 Undergrad Volume	FFY 2003 G/P Volume	School Lender Volume
				Millions	Millions	Millions
Case Western Univ. OH			X	\$8.303	\$49.216	\$30.294
Claremont Graduate Univ. CA	X	X		\$0	\$17.003	\$9.796
Cleveland Chiropractic College CA	X	X		\$0.850	\$13.155	\$2.211
Cleveland Chiropractic College MO	X	X		\$0.381	\$28.344	\$7.137
College of Wm. and Mary VA	X	X		\$8.052	\$13.982	\$0
Creighton University NB		X		\$10.343	\$55.672	\$5.795
Drexel University PA	X	X		\$39.850	\$56.708	\$2.642
Duke University NC		X		\$9.465	\$46.285	\$17.049
Duquesne University PA	X	X		\$21.571	\$28.019	\$13.357
Eastern Michigan University MI	X	X		\$54.069	\$17.790	\$2.175
Finch University IL		X		\$0.029	\$32.358	\$30.026
George Washington Univ. DC		X		\$18.830	\$94.033	\$17.943
Illinois College of Optometry IL		X		\$0	\$18.175	\$17.652
Illinois Institute of Technology IL		X		\$5.267	\$25.086	\$10.285
Kansas State University KS	X	X		\$60.214	\$17.862	\$15.071
Kirkville College MO		X		\$0	\$27.014*	\$26.658*
Life Chiropractic West CA		X		\$0	\$16.869	\$14.838
Mercy College NY			X	\$20.644	\$21.277	\$0
Michigan State University MI	X		X	\$91.592	\$74.682	\$53.813
MSU, Detroit College of Law MI	X		X	\$0.032	\$19.147	\$14.426
Midwestern University IL		X		\$1.710	\$81.106	\$58.626
Naropa University CO		X		\$2.359	\$8.366	\$6.319
National Univ. of Health Sciences IL		X		\$0.359	\$8.663	\$8.430
New York College of Podiatric NY			X	\$0	\$9.384	\$4.850
Northwestern Univ. IL				\$11.752	\$25.709	\$8.353
Nova Southeastern Univ. FL		X		\$37.062	\$422.945	\$374.681
Ohio College of Podiatric Medicine		X		\$0	\$6.068	\$0
Oklahoma City University OK		X		\$5.309	\$15.756	\$5.193
Palmer College of Chiropractic IA		X		\$0.696	\$68.702	\$52.453
Parker College of Chiropractic TX	X	X		\$0	\$29.876	\$7.541

Institution	New in 2003	FFEL	DL	FFY 2003 Undergrad Volume	FFY 2003 G/P Volume	School Lender Volume
				Millions	Millions	Millions
Pennsylvania College of Optometry		X		\$0.016	\$15.189	\$14.484
Pepperdine University CA		X		\$10.326	\$65.420	\$6.639
Regis Univ. CO****		X		\$22.315	\$33.619	\$32.467
Santa Clara University CA	X		X	\$6.968	\$4.946	\$0
Simmons College MA		X		\$5.601	\$23.929	\$23.060
Southern Methodist University TX		X		\$10.736	\$29.371	\$19.334
St. Mary's University TX		X		\$10.025	\$18.834	\$10.245
Stanford University Law School CA		X		\$4.910**	\$27.366**	\$7.517
Tufts University MA	X	X		\$7.146	\$61.866	\$26.256
University of Chicago IL		X		\$7.909	\$64.734	\$55.246
University of Dayton OH		X		\$22.145	\$16.153	\$13.015
University of Denver CO		X		\$10.681	\$60.961	\$49.760
University of Health Sciences MO	X	X		\$0	\$30.592	\$9.195
University of Maryland at Baltimore	X		X	\$4.305	\$58.897	\$13.080
University of Miami FL		X		\$33.017	\$80.078	\$49.979
Univ. of Missouri, Kansas City MO		X		\$29.729	\$53.614	\$53.232
University of Northern Colorado	X	X		\$21.772	\$10.708	\$1.686
University of Oklahoma OK		X		\$66.834	\$33.395	\$12.294
University of Pennsylvania PA		X		\$19.528	\$106.180	\$89.630
University of Phoenix*** AZ	?	X		\$0	\$555.931	\$0
University of Southern Mississippi		X		\$52.128	\$13.208	\$0.085
University of Tulsa OK		X		\$8.154	\$18.233	\$12.251
U. of Wisconsin, Oshkosh WI	X	X		\$21.311	\$2.770	\$0
Washington Univ. Law School MO	X	X		\$0	\$40.630**	\$16.923
Wayne State University MI	X		X	\$57.055	\$79.220	\$14.080
Western Illinois University IL		X		\$35.700	\$7.081	\$7.069
Western Univ. of Health Science CA		X		\$0.037	\$48.428	\$47.274
Widener University PA		X		\$9.596	\$38.415	\$35.101
Yale University CN		X		\$6.101	\$39.942	\$17.275

* Graduate and professional loan volume for FFY 2003 totals the graduate and undergraduate loan volumes for A. T. Still University in Missouri and the school-as-lender volume is the loan volume shown for that institution that was made to its graduate students by Kirksville College of Missouri.

** Graduate and professional loan volume for the entire institution.

*** Unable to determine status of the University of Phoenix's possible school-as-lender program.

**** Greentree Gazette reported that Regis College in Massachusetts was a school-as-lender school, but it is Regis University in Colorado that is the school-as-lender institution.

Appendix B:

Survey of School-As-Lender Institutions

After identifying 58 colleges and universities that have school-as-lender programs, the first step was to collect and analyze the basic factual data on the institutions: their school types, control, size, and location; their undergraduate, graduate, and first-professional enrollment; and their loan programs using Department of Education published reports and Web sites, the institutions' own Web sites, and data on the schools' recent federal fiscal year loan volume trends and lenders. Profiles then were developed showing the characteristics of all school-as-lender institutions, of the earliest group of school-as-lender institutions, and of those schools that started school-as-lender programs within the last two years.

After determining the identity and basic characteristics of school-as-lender institutions, an effort was made to interview key personnel at many of them by phone to secure more detailed information on: their primary objectives in switching to a school-as-lender program; the institutional personnel who championed the change; which and how many of their graduate and first-professional schools participate in the school-as-lender program; their administrative structure, including origination, servicing, and purchase arrangements; premium structure; loan sale timing; borrower benefits; use of program revenues; experience with their program; and advice for other institutions considering such a move.

A detailed interview questionnaire and script was developed to make sure all the salient points were covered at every school that agreed to an interview. Contact names and phone numbers for key personnel were obtained and interviews were conducted in 2003.

Interview Questionnaire

1. How many years has your institution had a school-as-lender program for its graduate and first-professional students?
2. Do all of the graduate/professional schools at your institution participate in your program?
 - a. If not, which ones do?
 - b. Which ones do not?
 - c. Do those that do not, participate instead in the Direct or the FFEL program for their federal loans?
 - d. What about your undergraduate borrowers?
3. What were the primary reasons or key considerations for shifting to a school-as-lender program?
4. Who were the institutional champions for the decision?
5. What method was used to select your program partner(s)?
 - a. Did you use a consultant to help with the procurement?
 - b. If so, who?
 - c. Who do you currently have as your partner(s) for your program?

What individuals either within your institution and in outside organizations helped facilitate the transition?
6. Was the school-as-lender program phased in starting with new, first-time graduate/professional student borrowers?
7. How is the administration of your school-as-lender program structured?
 - a. Does it rely on a lender/partner provided turnkey school lending program?
 - b. What, if any, components of the school-as-lender program does your institution administer itself?
8. What responsibility does your program partner have for any of the following:
 - a. Funding?
 - b. Origination?
 - c. In school and grace period servicing?
 - d. Publicity?
 - e. Entrance and exit counseling?
 - f. Life of the loan servicing?

-
- g. Default prevention?
 - h. Combined billing for federal and private loans?
9. What portion of the administrative costs (most could not specify even a rough percentage) is born by:
- a. Your institution?
 - b. Your school-as-lender partner?
10. Were there any specific financial and/or legal risks the school-as-lender program posed for your institution?
- a. If yes, what were they?
 - b. What steps did you take to minimize them?
11. Are your graduate/professional borrowers charged a:
- a. Guarantee fee?
 - b. Origination fee?
 - c. Was the buy down/elimination of the guarantee and/or origination fee an RFP requirement?
12. What kinds of borrower benefits do your school-as-lender borrowers receive?
- a. Timely-payment incentives?
 - b. ACH reduction?
 - c. Other Interest-rate reduction?
 - d. Other benefits? What? _____ How much? _____
13. Does your institution rely exclusively on its school-as-lender program for FFELP lending to its graduate and first-professional students?
- If not, is your school-as-lender program included with other lenders on a preferred lender list?
14. What is the relationship between your school-as-lender program for FFELP loans and private loans your graduate/professional students may need?
- a. Does your line-of-credit provider for your school-as-lender program also provide private loans for your borrowers?
 - b. Does your institution rely on other private loan providers as well?

How does the school-as-lender program for your graduate/professional students affect lender choices for your undergraduate students and parents who need federal and/or private loan funds?

-
15. What are the purchase arrangements for your school-as-lender loans?
 - a. How long are the loans held in your institution's name?
 - b. When does your line of credit provider purchase them?
 16. What kinds of purchase premiums are paid and how are the premiums structured?
 - a. A single premium for all school-as-lender loans sold?
If yes, how much?
 - b. What about premiums on serial loans?
 17. How much net revenue does your institution receive from its program?
 - a. What uses are made of these program revenues?
 - b. What students receive these benefits?
 - c. What form(s) do they take?
 18. Does your institution receive "opportunity funds" from your school-as-lender partner(s)?
 19. How would you characterize your experience with your school-as-lender program so far?
 - a. Has it met or exceeded your original expectations for it?
 - b. If yes, in what ways?
 - c. If no, why not?
 20. Are there any comments or suggestions you have for other institutions that may be thinking about starting a school-as-lender program?

1 See Appendix A for a complete listing of these institutions and some of their selected characteristics.

About the Author

Dr. Samuel M. Kipp, III, is the head of Kipp Research and Consulting, a firm specializing in higher education finance, demographics analysis, strategic planning and policy analysis services for universities, financial institutions, and other organizations.

His professional experience includes nine years as the Executive Director of the California Student Aid Commission, where he was responsible for the annual delivery of \$2 billion in grant and loan aid to over 400,000 California students. He served as Chairman of the National Council of Higher Education Loan Programs during the 1992 Reauthorization of the Higher Education Act and was a founding board member for the National Student Clearinghouse. From 1977 to 1985, he was a senior staff member at the California Postsecondary Education Commission and authored numerous policy studies on California higher education issues. Often a keynote or featured speaker at national, regional, and state conferences and meetings, he also has been called upon to testify as an expert witness on a number of occasions.

Dr. Kipp received both his B.A. and his M.A. degrees from the University of California at Davis and his Ph.D. in History from Princeton University. In 1995-96, he also served as a Visiting Scholar at the University of Berkeley's Graduate School of Public Policy and its Center for the Study of Higher Education.

Access Group, Inc.

Access Group is a nonprofit organization dedicated to providing access to education through affordable financing. The company specializes in graduate student loans, including loans for law, medicine, graduate business and graduate health studies.

For more than 20 years, Access Group has been committed to providing the education funding that students need, as well as high quality service and a variety of educational services for students and schools, such as the WiseBorrowerSM Curriculum, which promotes fiscal responsibility for students. For more information, please call 800-227-2151 or visit www.accessgroup.org.

Additional Copies

To order additional published copies of this report, please call Access Group at 800-227-2151. You can also download the report from our Web site at www.accessgroup.org.



1411 Foulk Road

P.O. Box 7430

Wilmington, DE 19803-0430

800-227-2151

www.accessgroup.org