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College Student Loans - - Another Black Eye for Private Enterprise

America's manufacturers, like so many other of our industries, depend on access to the pool of highly educated students completing their higher education. Our products, the equipment we use, the people who run that equipment and the management of our enterprises now require technical, engineering and organizational skills available only at our colleges and universities.

These days, getting a higher education usually means being able to pay for it, and, for most families, that is no small challenge. More and more, students must borrow what they need to go to college. To a large extent, America has relied on private enterprise to provide those loans.

We have written before in these letters about instances where our free market has been compromised by counter-competitive practices or heedlessness to economic realities. Some months ago, we described how State and local governments were enticing companies to locate in their jurisdictions by offering generous tax and other financial subsidies. More recently, we described how the subprime mortgage market had become a buccaneer's paradise based on illusory credit checks, inflated appraisals and the age-old hope that what goes up will not come down.

Sadly, the scandalous behavior of certain universities and lenders in providing academic loans to students and parents offers another example.

By way of background, the student loan business, which ran to \$85 billion last year, has a two-tier structure. The first is a system of government loans to students and/or their parents. These loans have carried interest rates of 5% (for needy students), 6.8% (for other students) and 8.5% (for parents of dependent students). For some time, this program was run exclusively through subsidized and guaranteed private lenders; they essentially had zero risk, both in terms of default and interest income. In the 1990s, the federal government supplemented this program by making loans directly to students, without intermediaries.

Because the federal loan program is capped for most students at a small fraction of today's college costs, a second tier of private loans has emerged. Those loans are set at "commercial" rates, based primarily upon the student's (or co-signer's) credit rating. Most colleges provide consultants to students wishing to borrow from a commercial lender.

Recent investigations of this program have produced revelations like the following:

- A Senate report disclosed that a financial aid official of Johns Hopkins collected some \$65,000 in consulting fees and tuition payments from a commercial lender. The school agreed to pay \$1.1 million to settle an investigation by the New York State attorney general. Columbia University made a similar payment in settlement.
- Other schools demanded payments from lenders to support various expenses, like student receptions, tee shirts and CDs. In many of these cases, the "contributions" were aimed at assuring that the lender would be recommended by college staff.
- In the University of California system, some students were paying over 19% interest on commercial loans and up to 8% in fees. The University put all their students' loan business out for competitive bidding; this year, the rates will run from 7.75% to 14.25%, with no fees.
- Like subprime mortgages, college loans are being repackaged for sale to investors. The steps in this process provide large amounts of income to the packagers, but not much relief to the students. For example, on a typical \$10,000, 11% loan, the student must pay \$650 for default insurance, the bank receives \$550 as a marketing fee, the packager takes another \$1,800, and the investors receive 6%. In effect, the student's 11% (guaranteed) interest payment is supporting \$2,300 of income to the lender and packager, with enough left over to be attractive to investors.

The Congress recently passed legislation that will temper some of the excesses in the student loan program, notably by cutting the subsidies given to private lenders under the federal loan program and using that money to reduce interest rates, by prohibiting the conflicts between colleges and their students and by requiring competitive bidding for commercial loan programs.

After World War II, millions of servicemen and women got a college education through the GI Bill of Rights. Many historians credit that program for the creation of the world's finest system of higher education, not to mention the cadres of educated citizens required to produce the world's leading economy. The GI Bill was a government program, with no overlay of commercial lending, no fees for bundling and marketing, no conflicts of interest scandals and a good deal of benefit to our country. It is a shame that our new efforts to educate our young have wound up costing so much and doing more harm to the reputation of our free enterprise system.

Here are the specifics on costs for this month:

- Scrap and Pig Iron. After three months of holding steady, the prices for #1 dealer bundles and #1 busheling (Chicago) were up \$32 per mt, or 10%, to \$330 and \$332, respectively. In contrast, the spot price for Brazilian pig iron (cif New Orleans) stayed at the \$375 per mt where it has stood for six of the last seven months.
- Natural Gas. The Nymex contract price declined again to \$5.65 per mcf. This is the second lowest price since September, 2004 and is \$2.45 below the level of only three months ago.
- Exchange Rates. The dollar hit an all time low against the euro, which at this writing stood at \$1.41, up six cents from last month. The pound was up three cents to \$2.03, and the Canadian dollar rose six cents to parity with the US dollar for the first time in almost 35 years.

Please share your thoughts and suggestions with us. As always, we are posting this letter on our website, www.coreysteel.com, and on the international site, www.steelonthenet.com.