

STUDENT LOAN MARKET UPDATE

A preferred lender list: how and why it's constructed on today's campus

BY JUSTIN DRAEGER

Mention "preferred lender lists" in a room full of financial aid administrators or lenders, or college students or policy makers, and you'll evoke an array of responses from contempt to defensiveness to downright weariness. Preferred lender lists are a "hot-but-ton" issue in student lending. The issue takes up time and space in association and trade meetings, newspapers, and even in federal negotiated rulemaking.

And why shouldn't it? Making a school's preferred lender list could mean life or death for a lender, certainly on that campus. It's likely that 90 percent or more of all student loans at an institution are made by lenders found on the school's preferred lender list.

Accusations, some of them potentially slanderous, are being reported in the media about the relationships between schools and lenders.

It's my experience that most schools methodically compile preferred lender lists year after year to help their students answer the question—"which lender is right for me?" In doing so, school personnel use one of three strategies: weeding out, ranking and scoring, or a comprehensive blend of the two.

Weeding out

Schools that 'weed out' lenders maintain a set of minimum standards that a lender must meet in order to be listed. A simple "yes/no" questionnaire may gather the lender data that's needed. From the data, schools try to establish benchmarks to ensure students are borrowing from legitimate, steady, and responsible lenders with track records that demonstrate their commitment to students.

Track record grows increasingly important as the student lending field expands. Type "student loans" into Google, and in less than one second you'll be looking at 22.8 million results.

Student lending is confusing enough without the myriad lenders and pseudo-lenders that have recently implemented a direct-to-consumer business model. Schools follow the weed-out process so that the lenders who remain on their list meet minimum requirements in such areas as length of time in the industry, electronic communication and delivery standards and borrower benefits.

"We don't want lenders who are here today and then gone tomorrow," says Sarah Bauder, director of financial aid at the University of Maryland. "If a lender goes out of business before a student finishes school," continues Bauder, "his or her loan may be sold to another lender. A borrower may then have to use still another lender for the rest of his or her schooling." The University of Maryland maintains its preferred lender list with a seven member panel consisting of both financial aid and non-financial aid personnel. Its lenders must have at least five years experience in the business.

Schools understand that multiple lenders often mean multiple payments, which can further complicate an already complicated system. Schools understand that borrower benefits differ greatly from lender to lender. However, many schools require preferred lenders to offer benefits that are offered almost universally by all other lenders, such as discounting the loan origination fee.

Schools that use the weed-out strategy often have many preferred

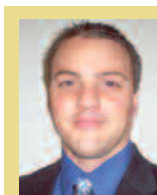
lenders. "We offer enough options so that no one lender corners the private loan market," said Betsy Hicks, director of student financial services at MIT. "We are willing to certify any private loan, and we try to provide expert counseling so students know how to make an intelligent choice," she continued.

Ranking and scoring

Schools using this method score lenders on an array of desirable lender attributes. They may or may not assign different "weights" to each scorecard item. Often examined first are a lender's borrower benefits. The more money a lender can save students, the higher the score. However, borrower benefit scoring can be tricky, because many borrower benefits are lost if a borrower pays late or consolidates his or her loan. A ranking/scoring school may request and publish a lender's borrower benefit success rate.

Lenders usually recognize that the actual cost to the borrower is an important disclosure to students and schools. "Lenders need to be competitive to expect to be on a school's preferred lender list," says Phil Van Horn, Chairman of the Board of Wyoming Student Loan Corporation.

Customer service and value-added support for borrowers are often ranked and scored. Though schools are responsible to the U.S. Department of Education for their cohort default

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A loan collection *Anecdote*



When you're in the business of helping people, extreme life circumstances can require extreme solutions.

Forty years ago, a U.S. armed forces veteran survived a car accident with permanent mental, physical and emotional disability. Three years after the accident, he attempted to get his life back on track. Taking out a \$1,500 Stafford loan, he enrolled in a vocational program at a for-profit school. But after attending a few weeks of classes, he needed additional surgery and had to cut his schooling short. However, the school kept the loan money.

Since he had neither the money nor a complete education—and was still disabled—the borrower incorrectly assumed that the loan was cancelled. Instead, his loan became a default.

Fast forward to 2006. He's now living in a state-run soldier's home. His disability had progressed even further, and he's being taken to court over the defaulted loan balance, which had grown due to additional fees. With the borrower's permission, a case manager at the soldiers' home wrote to American Student Assistance (ASA), the guarantor.

The letter helped make clear the veteran's situation and initiated an "Inability to Benefit Waiver" of his debt. Recognizing the extraordinary medical circumstances of this case, ASA granted a general amnesty on repayment of the outstanding balance. The account is "settled for less than the full balance" and is considered closed.

The mediation of the case manager helped resolve this long-standing default, says Christopher Callanan, ASA litigation associate. "The borrower's psychological and emotional problems were preventing him from fully explaining his circumstances to us. Acting as a third-party negotiator on his behalf, the case manager helped bring about a faster resolution."

"There were so many out-of-the-ordinary facts and questions surrounding this situation," Callanan continues. "For example, why was the loan not canceled when the borrower withdrew from school? But the age of the case is an obstacle. The school is no longer in business. And 35 years ago the federal student loan program was still in its infancy. The regulations that now protect borrowers and lenders from fraud were not as clearly defined. Regardless, the reality today is that the borrower is simply unable to repay the loan."

"We recognize exceptional conditions that prohibit a borrower from meeting his obligation," explains Grace Bartini, ASA ombudsman. "When it's warranted, amnesty can make a real difference in the life of a borrower who's struggling."

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rates, campus staffers believe that lenders also share the responsibility to ensure successful student loan repayment. Schools want lenders to be engaged in default aversion and student success activities.

"Schools can differentiate between lenders who are just trying to collect a bill and lenders who stay in contact with their students after graduation to help them in any way possible," continues Van Horn. "It comes down to good service, good service, good service."

Schools who rank and score may build a matrix that includes numerous factors such as a lender's mission statement, merger and acquisition history, default rate, default aversion resources, local and national reputation, security and privacy history, online web applications, pre-application processes, interest rates, upfront origination fees, quality of materials delivered to students, frequency of communication with borrowers, free checking and savings accounts, financial planning and debt management services, investment services, and more.

A blended approach

Some schools may use both of the methods discussed above. First, a lender must meet certain minimum standards, and next, the lender is scored using weighted criteria.

Are schools looking for favors from lenders that do not benefit borrowers? "Financial aid administrators feel just as uncomfortable with unethical exchanges as lenders," says Dallas Martin, president of the National Association of Student Financial Aid Administrators. "The idea that financial aid administrators want or expect lenders to offer funding for their programs is incorrect, and lenders should stand firm in not offering anything that borders on unethical or illegal behavior."

With all the above said, ultimately the lender choice is the student's. "We have been able to select lenders who are able to provide the best services and products to our students and parents in three categories: pricing, technology, and customer service," says Bauder. Ideally, a preferred lender list is the intersection of a borrower's, lender's, and school's goals. ■