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The True Default Rate for Federal Student Loans

Last week, the Chronicle of Higher Education reported that 1 in 5 students graduating in 1995 have since defaulted on their student loans. While we are pleased that this critical issue has finally been examined by credible media investigation, we feel strongly that the Chronicle piece raises multiple related questions that merit further investigation.

First: Based on Inspector General Data initially reported on by Nick Perry of the Seattle Times, and in view of recent 5-year default data, We are confident that the true default rate across all federal student loans is between 25 and 33 percent (perhaps even greater)- clearly higher than described in the Chronicle article, and higher even than the default rate for sub-prime home loans, payday loans, credit cards, or any other lending instrument in this country. Students and their parents deserve to know this before making college attendance and financing decisions. The failure of government to warn citizens about this alarming default rate over the past decade has caused immeasurable harm. We hope the media will continue to pursue this line of investigation.

Second: The American Public was, for decades, exposed to consistent, repeated claims by the universities, student loan companies, and even the Department of Education that the default rate was low (between roughly 4 and 7 percent) during the same time period. The fact that the the true default rate was likely higher than that for subprime home mortgages, or any other type of loan in the country, had it been communicated to the public by the Department of Education, would have saved a tremendous amount of harm that has occurred in the country due to citizens taking out loans without knowing the risk. Therefore, we ask the media to put additional pressure on the Department of Education to come clean about what the true default rate is for federal student loans, explain why this large rate was never clearly announced as a warning to the public, and investigate the question of why, institutionally, the Department of Education would be inclined to conceal the true default rate. The fact that the recovery rate for defaulted federal student loans is 123 percent (compare this with the 20-30 percent rate for credit cards) should provide a clue.

Third: we ask the media community to consider the facts in an objective manner, and consider whether it is appropriate to focus solely on the for-profit colleges. We feel that it clearly is not. The default rate for four-year institutions and community colleges are also astonishingly high, as the Inspector General study referenced above clearly shows. These data, taken together, prove that we are faced with a predatory,lending system that promotes inefficiency, poor oversight, inflation, and a high default rate. It profits when students fail.... and documented activities by multiple lending companies since 1998 clearly demonstrate their motivations to default loans rather than working with borrowers to keep their loans in good stead.

We agree that the Direct Lending system is architecturally a more efficient lending system, and applaud President Obama for making this change. Unfortunately, this problem persists- it transcends the lending system type (FFEL/Direct), and may even be worse under the Direct system. This predatory environment problem is directly linked to the removal of bankruptcy, statutes of limitations, Truth in lending requirements, and other fundamental consumer protections over the years, along with the creation of collection powers that know no equal. Serious inquiry will reveal that the poor government oversight of the system, the inflation that has run rampant through our colleges and universities, and (arguably) the laundry list of conflicts, illegal activities, and other misdeeds discovered in recent years are also closely linked to this astonishing removal of consumer protections. Removing bankruptcy and other protections was an experiment, and an extremely harmful and costly one.

We commend the Chronicle for this work. Clearly, the free press must take its public service duty seriously, and dig more deeply into this issue. Citizens will be very glad to have been presented with the truth surrounding these questions, as ugly as it may turn out to be. It is only after understanding the problem without exaggeration or diminution that a suitable solution can be determined and achieved.We look forward to supporting these efforts.

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