

Insight



A Demonstration Program: The Use of Private Capital in the Federal Direct Student Loan Program

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The 2009 switch to direct student lending, billed as a means to bolster student financial aid spending by eliminating private sector ‘middlemen,’ has not only failed to produce the anticipated savings, it has cost taxpayers billions of dollars and shifted billions more onto the federal balance sheet, forcing the Department of Treasury to borrow money to keep the program afloat.

There is a better way. Currently, the government has precluded the use of the vast private capital markets willing to lend to students. Tapping into those markets would shift costs away from the federal government and generate billions in potential savings.

To evaluate this potential solution, Congress should develop a pilot program to determine if it is economically beneficial to utilize private capital in the long-term funding of Federal Direct Student Loans. A simple pilot program would provide all of the data necessary to make an informed policy decision. The basic outline of the pilot would look something like this:

- Authorize the Secretaries of Education and Treasury to conduct a pilot program that tests the use of private capital instead of Treasury borrowed funds to support the Federal Direct Loan Program (FDLP).
- The scope of the pilot program involves \$150 billion in current student loan assets—loans will remain the property of the U.S. government.
- Qualified Private Capital Providers (QPCP’s) would bid on portions of the package of loans in exchange for the cash flows derived from loans over time.
- QPCP’s include public, private, and non-profit sector pension funds, credit unions and other depository institutions, investment funds, corporations, and individuals.
- All other aspects of the FDLP, including servicing, remain as they are—managed by the Department of Education.
- Require the government to use Fair Value Accounting (FVA) in lieu of the Fair Credit Reform Act (FCRA) model to evaluate true costs and benefits of the pilot program.
- Savings derived from the pilot program and/or a broader scale implementation may be directed by the Congress to purposes established by law.

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