Trump Administration Hires McKinsey to Evaluate Student-Loan Portfolio

High default rates have Education Department weighing sale of debt, other measures to reduce taxpayer exposure

About five million borrowers who owe nearly $106 billion are in default on student loans made directly by the government, according to Education Department data. PHOTO: SETH WENIG/ASSOCIATED PRESS
WASHINGTON—The Trump administration has retained private consultants to estimate potential losses in the U.S. government’s $1.45 trillion student-loan portfolio, and is weighing selling all or portions of the debt to private investors, according to administration officials familiar with the matter.

A potential sale is one of several options the White House is considering to address the student-loan program’s deteriorating finances.

The administration’s review has been prompted by a surge in recent years in borrowers’ defaulting on their loans and entering federal debt-forgiveness plans, developments that have severely drained money coming into the government’s coffers. The debt held by the government continues to balloon as interest accrues on existing loans and as new students take out debt to go to school.

The Education Department has hired the consulting firm McKinsey & Co. to study how much money could be lost if low repayment rates persist, an agency spokeswoman said. Meantime, President Trump’s top economic advisers in the White House are studying ways to improve the program’s finances, senior administration officials said.

One option under early consideration is to sell at least a portion of the portfolio, a plan that has been discussed previously by Republican policy makers but faces many obstacles, including whether the government could find interested investors at the right price.
Under such a plan, the government would maintain its role as the nation’s primary lender to college and graduate students, but the government would raise money up front, instead of waiting years for borrowers to make payments, and take the debt off its books. Investors would then assume the long-term risk of the loans.

Administration officials say they are far from making any decisions and are considering other options as well. They are also looking at how Washington responded to the failure of hundreds of savings-and-loan institutions in the 1980s by creating the Resolution Trust Corp., which disposed of their assets, an administration official familiar with the discussions said. Officials declined to elaborate on other possible options.

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An Education Department spokeswoman said the McKinsey study is about doing accurate accounting.

“It’s about getting a clear understanding of the state of the portfolio,” said Liz Hill, a spokeswoman for Education Secretary Betsy DeVos. She said the review “is the responsible thing to do, since we’re charged with overseeing it.”

About five million borrowers who owe nearly $106 billion are in default on student loans made directly by the government, meaning they went at least 360 days without payment, Education Department data show. Many others are at least 30 days behind. In total, 43
million borrowers have federal student loans, though many are still in school and not required to make payments yet.

The Education Department hired McKinsey to project how much student-loan borrowers will repay, with interest, in the coming years and decades. The government’s own projections in recent years have come in too high, forcing budget officials, including under the Obama administration, to cut the estimate by billions of dollars.

The administration anticipates that the student-loan program as a whole will return a profit. But its confidence in that projection has become shakier given repayment trends. Any underestimate could result in potentially billions of dollars unaccounted for. The review could also help determine the price at which the government would sell loans.

The amount Americans owe in federal student loans has nearly tripled since 2007, Education Department data show, driven by the recession and weak recovery, along with rising tuition. Many workers enrolled in college and graduate school to upgrade their skills. The government, now one of the world’s biggest consumer lenders, has struggled to do basic accounting, in part because Congress has repeatedly tweaked the law, changing interest rates and the terms under which borrowers repay.

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Many borrowers continue to default despite historically low unemployment. And millions of others have enrolled in plans—known as income-based repayment—that set their monthly payments as a share of their incomes, typically slashing their bills by hundreds of dollars a month. The income-based plans also promise, for many borrowers, that a portion of their debt will eventually be forgiven.

The Higher Education Act, a longstanding law that authorizes the student-loan program, allows the education secretary, after consulting with the Treasury secretary, to sell student loans if the terms are “in the best interest of the United States.” The law prohibits any sale that would result in a cost to the government. It states that any money made off
the sale could then be used to reduce interest rates for borrowers “to encourage on-time repayment.”

The law suggests the administration would only be able to sell off “good” debt—or loans being repaid by the most successful borrowers, such as graduate-degree holders. Many such borrowers in recent years have already refinanced with private lenders at lower interest rates.

Jason Delisle, a scholar at the American Enterprise Institute, a conservative think tank, said the government would likely lose money, in the long run, if it sold loans. “Investors are going to demand a really big premium,” Mr. Delisle said.

The hiring of McKinsey to analyze the portfolio could have additional aims. If the review shows that the student-loan portfolio brings in less money than previously understood, the administration could gain more support for initiatives to pressure schools to rein in tuition increases. For example, the White House has suggested developing a system to put colleges on the hook to help pay off their graduates’ outstanding debt.