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One company will now handle close to half of all student-loan payments

By [Jillian Berman]

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What the merger of two payment processors means for America's $1.4 trillion student-loan burden

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BERMAN

Every month, approximately 40 million Americans make payments to a corporation they know almost nothing about.

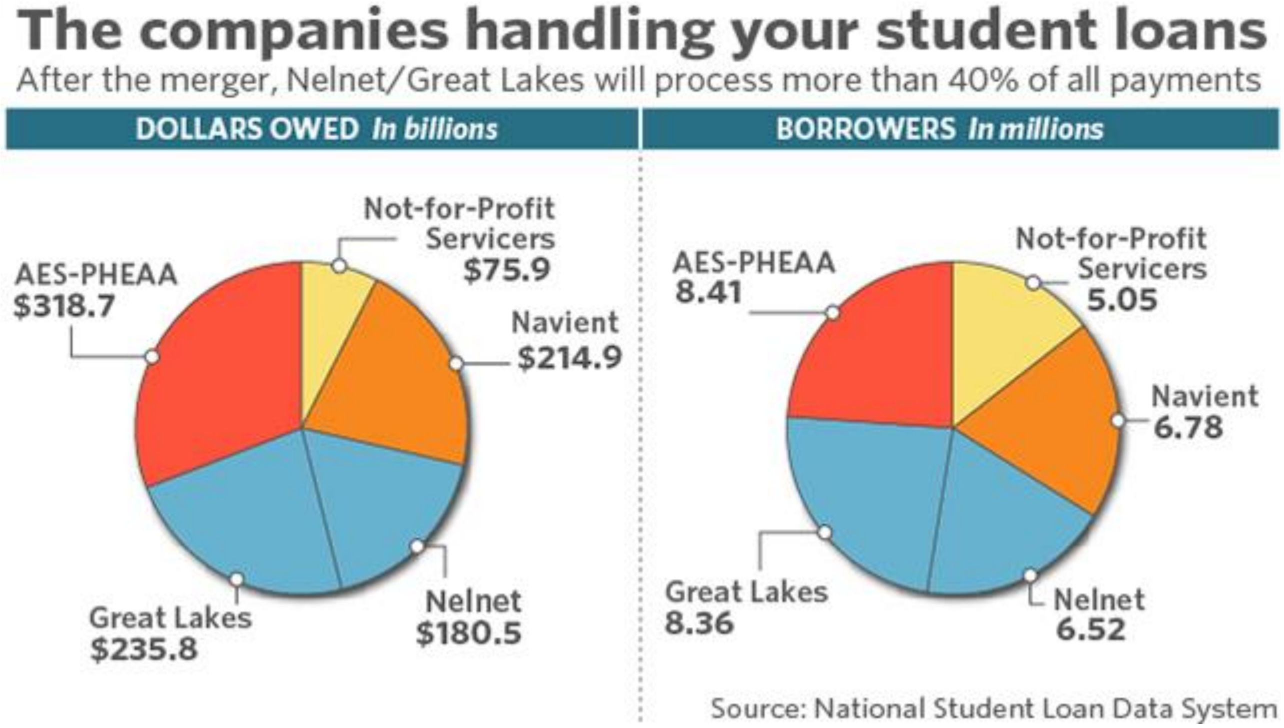
There are just four major companies contracted by the federal government to process the nation's student loan checks and after the just-completed merger of two of these firms — Nelnet Inc. NNI, +1.92% and Great Lakes Educational Loan Services Inc. — one company will handle more than 40% of all payments.

While it might not seem to matter who processes the payments, these companies have an outsize role in the shape of America's $1.4 trillion student-loan burden. Though the rising cost of college and stagnant wages are the most cited reasons for our nation's student-debt problems, borrower advocates, law-enforcement officials and the Consumer Financial Protection Bureau have said the student-loan industry itself is also to blame. These processors can often make the difference for struggling borrowers between successfully paying down a debt and the nuclear option — default.

In an ideal world, no federal student-loan borrower would default on his or her debt, thanks to the myriad of programs available through the government, but, in reality, roughly 1 million defaulted last year — a sign, advocates say, that student-loan servicers don't work sufficiently in borrowers' best interests.

All of which is why the merger of two of these entities is important to watch. Nelnet announced Wednesday that it had completed the merger after the Department of Justice initially requested more information.

As of Sept. 30, 2017, the date of the latest available government data, Nelnet and Great Lakes were in charge of a combined 42% of the loans held by federal student-loan borrowers and more than 40% of the balances — the highest proportion of any entity. In a news release, Nelnet said the newly combined company would service $397 billion in government-owned loans for 13.4 million borrowers. Those numbers are based on newer company data, but it's hard to say how they fit into the larger servicing picture as the latest government data on the overall portfolio were released in September.



Terrence Horan

As of September 2017, Nelnet and Great Lakes combined serviced the largest entity of loans.

Now, a publicly traded company many have never heard of is poised to take on an even larger role in a contentious industry.

Ben Kiser, a spokesman for Nelnet, wrote in an emailed statement that the company is "pleased" to complete the transaction after the Justice Department's antitrust review, adding that the company has focused on providing the "best service possible" for more than 40 years.

"Over the years, we have learned a lot from our experiences and are proud of the leadership we have provided to improve student loan service for millions of borrowers," Kiser wrote. "We know there is much more opportunity to make repaying student loans easier and friendlier for borrowers and we look forward to leading these improvements with Great Lakes."

Still, such a high level of consolidation "creates an incentive to make these servicers too big to fail," said Whitney Barkley-Denney, policy counsel at the Center for Responsible Lending, a consumer advocacy organization. "It just creates more risk for the borrower when so much of it is concentrated."

And given Nelnet's somewhat troubled past, the prospect of the firm handling such a large share of the government's business and borrowers' accounts is particularly concerning, advocates say. "There is a history there that I really can't get completely beyond as somebody who lived through it," said David Bergeron, a senior fellow at the Center for American Progress, who worked at the Department of Education for more than 30 years.

The end of the loan

Though it may not be well known, Lincoln, Neb.–based Nelnet's reach stretches far beyond the borders of the Cornhusker State. As of the end of 2016, it owned nearly $25 billion in student loans, earning money on the interest.

Once the company's bread and butter, the loan business is winding down in the wake of the Obama administration's 2010 decision to begin making loans directly from the government to students.

Nelnet has prepared for that eventuality for years, acquiring companies, including FACTS, which helps private and religious schools process tuition payments. That division is poised to grow if Secretary of Education Betsy DeVos gets her way and is able to expand so-called school choice programs that send government dollars to private schools. Nelnet also acquired academic publisher Peterson's — which it recently sold — and owns a telecommunications provider, and has an investment in a sports team management software companyAll told, Nelnet made more than $200 million in net profit in 2016.

"We are not the same company that we were 10 years ago, 15 years ago, 20 years ago," said Terry Heimes, the company's chief operating officer, in a 20-minute video history of Nelnet that the company published last year.

The Great Lakes takeover fits in with that strategy, according to Michael Tarkan, a senior analyst at Compass Point Research and Trading. It also aligns better with the core business than some of the other recent acquisitions, he said. Not including the Great Lakes acquisition, Tarkan has estimated that the servicing lines of business will account for between 10% and 15% of Nelnet's earnings in 2017.

Nelnet's stock rose about 1% Thursday, the first full day following the announcement of the Great Lakes deal's finalization, and then edged lower by about 2% on Friday.

From nonprofit to for profit

Nelnet has its origins in a Nebraska-based nonprofit, NebHelp, founded in 1978.

In 1998, the company began the process of converting to a for-profit entity that became Nelnet, but, for the conversion to be legal, Nelnet was required to preserve NebHelp's assets for the public good. Nelnet set up a nonprofit to comply with this requirement.

Advocates, however, raised questions about how the nonprofit was run. The Consumers Union, Consumer Reports' policy organization, said in a report at the time that because the foundation — intended to help low-income students go to college in Nebraska — required students to take out a type of loan that the University of Nebraska–Lincoln didn't accept, it was useless to anyone who wanted to attend the state's flagship university. That category of loan was also the type offered by Nelnet.

The foundation also spent $800,000 a year on "education planning centers," meant to help students prepare for college. But Nelnet was the only for-profit lender allowed to advertise in those centers, and the only application form available at the centers was for a program Nelnet operated, according to a report at the time.

At the time, the head of the foundation created through the old NebHelp assets told the Associated Press, "I think it's fair to say we followed an appropriate process."

Nebraska's attorney general eventually found that the company had violated state law by using the charity's assets to promote the for-profit corporation, according to a 2012 Omaha World-Herald story. But he only meted out a "slap on the wrist," the paper said, approving corrective measures that the company itself had proposed.

Some of Nelnet's loans, meanwhile, were eligible for a government subsidy that lawmakers and officials later accused the company of collecting improperly.

In the 1980s, the government offered a guarantee on student loans made through tax-exempt bonds, like those originated by NebHelp. Under the rule, lenders were paid a 9.5% interest rate but agreed to be reimbursed at half the normal special allowance rate if interest rates were above 9.5%, even if they offered a lower rate to students. When the rates were high, this saved the federal government money, but in historically low-interest-rate environments, that made the loans huge money makers.

Congress eliminated the subsidy for most loans in 1993, but Nelnet managed to substantially increase the number of loans it held that still would qualify. According to a 2006 report from the Department of Education's inspector general, Nelnet increased its portfolio of loans that qualified for the subsidy from $551 million in March 2003 to about $3.6 billion in June 2004.

"Our analogy of this at the department … [was] that you would put a dead dog in the freezer with filet mignon and sell the dead dog as filet mignon," said Bergeron. "That's essentially what they were doing."

Nelnet, the inspector general's office estimated, was "improperly" paid more than $278 million by the government as a result.

Ultimately the company reached a settlement with the government. That agreement required it to forfeit future subsidies the company said it was eligible to claim, even as the company's co–chief executive at the time, Mike Dunlap, disputed the findings of the Education Department report.

"We are pleased to have reached a resolution that allows us to avoid costly litigation to demonstrate the merits of our position," Dunlap said, according to Lincoln Journal-Star reporting at the time.

As part of the agreement, Nelnet did get to keep the $278 million targeted in the audit report, however. In the end, according to Robert Shireman, a senior fellow at the Century Foundation and a former deputy undersecretary of education, the deals amounted to a taxpayer financing of the company’s growth.

“That basically is what created Nelnet as a company,” Shireman said.

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Paying student loans for the first time? Here's what you need to know

Investigations

Months after the subsidy scandal, Nelnet found itself caught up in a probe led by then–New York Attorney General Andrew Cuomo.

As part of the probe, Cuomo singled out Nelnet for its relationship with alumni associations. He claimed the company entered into agreements with these groups that in some cases allowed the firm to use the schools’ logos for marketing purposes and in others provided a kickback to the alumni organizations when they steered borrowers towards the company’s product. What’s more, Cuomo alleged Nelnet paid for spa treatments and sports tickets for financial aid employees.

Ultimately, Nelnet paid $2 million to settle the claims. Nelnet’s president at the time and its current chief executive, Jeffrey Noordhoek, claimed that the company hadn’t violated any laws, according to a 2007 New York Times report.

“We are pleased to put this inquiry behind us,” he told investors on a conference call, according to the report.

But the company found a protector of sorts in Jon Bruning, Nebraska’s attorney general at the time. He initially waived the nearly $1 million settlement the company agreed to with his state after Cuomo announced his $2 million deal and repeatedly criticized his New York colleague over the investigation.

Ultimately Bruning reinstated his deal with Nelnet amid criticism that $16,000 worth of campaign donations from Nelnet and those affiliated with it made him too cozy with the company, according to a Lincoln Journal-Star article from the time. A year later, he bought a $675,000 vacation home with two Nelnet executives, according to the Omaha World-Herald.

The company has continued to work to stay on politicians’ good side — donating $167,587 during the 2016 campaign cycle, according to the Center for Responsive Politics, which tracks political giving. The Great Lakes deal has the potential to help increase goodwill among lawmakers towards Nelnet, Bergeron said. Great Lakes is headquartered in Madison, Wisc., expanding Nelnet’s footprint beyond Nebraska. That geographic diversity offers more politicians eager to protect the company in its constituency, he said.

Nelnet has largely stayed out of the headlines since the 2007 settlements — even as the student loan industry began to capture the attention of regulators, policymakers and the public.

As more students have increasingly taken on more debt, consumer advocates and regulators have raised concerns about the companies that help borrowers manage this growing debt are treating them. They've said that servicers often don't provide borrowers with the right information to find repayment programs that work for them.

The government can incentivize servicers to do the right thing through its contract with the companies, advocates say. The Trump administration is in the midst of soliciting proposals from companies to participate in the student loan program when the current contract expires in 2019.

It's hard to say, once the new contract is awarded, whether the combined Nelnet and Great Lakes will be responsible for the same large percentage of loans they handle currently. Still, Tarkan, who follows education companies, said in a recent note that the deal "positions Nelnet well to participate," in the new contract.

Some of Nelnet's competitors, meanwhile, have attracted unwanted attention.

Navient is facing multiple lawsuits, alleging the company steered borrowers towards repayment options that were better for its bottom line than that of their customers. And the Pennsylvania Higher Education Assistance Agency (PHEAA), another major servicer, was the subject of a New York Times investigation last year that accused the company of collecting money from borrowers for loans for which they didn't have proper documentation.

Still, Nelnet's history and the potential pitfalls of concentrating so much power in a handful of companies has some consumer advocates wary. And as government contract officers mull whether to award Nelnet more lucrative business, Deanne Loonin, a consumer advocate and the co-author of Student Loan Law, a book detailing the rights of student loan borrowers, said the company's track record and history should be an important consideration.

"We forget at our peril," she said.