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For-Profit Sallie Mae Wants to Buy Public Agency PHEAA, Which Vehemently Opposes Being Sold

Much more than an academic question; The two student-loan companies are in bitter fight, hurling allegations.

By Brett Marcy

HARRISBURG - It's the \$1 billion question. Maybe more.

Should the General Assembly sell Pennsylvania's lucrative and successful student loan enterprise for a tidy profit?

State lawmakers have begun to tackle that question, recognizing that there is more to the issue than just dollars and cents. Political loyalty and the welfare of Pennsylvania's college students also come into play.

The Pennsylvania Higher Education Assistance Agency, otherwise known as PHEAA or its corporate name, American Education Services, is far and away the most dominant student-loan servicing business in the state. It's also third-largest in the nation, with \$33 billion in total assets and controlling 80 percent of the student-loan market in the state.

That might explain why Sallie Mae - the nation's largest student-loan servicing business, which employs about 750 workers in its Wilkes-Barre office - is so eager to buy PHEAA's loan business.

The \$1 billion deal would catapult Sallie Mae to front of the student loan pack in the Keystone State - one of the few areas in the nation where it is not the No. 1 player.

PHEAA's board of directors has been staunchly opposed to a buyout, rejecting Sallie Mae's offer with lightning speed. But \$1 billion is a lot of money, and several state lawmakers said the Sallie Mae proposal deserves a closer look.

The pitch

The feud between Sallie Mae and PHEAA came to a head in December, when Sallie Mae approached PHEAA with an offer to buy its student loan business for \$1 billion.

The offer was quickly rebuffed by PHEAA's board of directors, which mostly consists of state lawmakers, including state Sen. Charles Lemmond, R-Dallas.

"PHEAA is not now and never will be for sale, especially to a profit-driven corporation with a track record for overcharging borrowers, laying off workers and gobbling up any organization

that stands between students and a quest for bigger profits,” said PHEAA Board Chairwoman Elinor Z. Taylor, in a December news release.

“We have an obligation to protect the long-term interests of Pennsylvania students and to be wise enough to see through a get-rich-quick scheme designed to enrich shareholders, not the Commonwealth of Pennsylvania.”

Although PHEAA’s board controls the policy issues of the agency, it’s the state legislature that has the ultimate say on whether to sell or retain PHEAA’s student loan business.

That gave Sallie Mae officials a chance for an end-run. The company quickly responded to PHEAA’s rejection with its own statement.

“We are disappointed but not disheartened that PHEAA dismissed our proposal out of hand,” said Sallie Mae Vice Chairman and Chief Executive Officer Albert L. Lord. “However, we so believe in the value of this business proposition for all parties that we do not retract our offer but rather seek a fairer hearing of its details.

“PHEAA’s statement greatly distorts the intent and structure of the proposal. . . . When fairly evaluated, commonwealth taxpayers will be \$1 billion better off, and Pennsylvania students will benefit from even lower college costs as a result of the proposed transaction.”

The state House responded by holding a hearing on the issue in February, but neither the House nor the Senate has taken any official action on the Sallie Mae bid.

House Majority Leader Sam Smith, R-Jefferson, said it’s unlikely anything will happen before June 30 - the date by which the legislature must approve the 2005-06 budget.

“It’s pretty much on the back burner, and I don’t expect it to be moved to the front burner over the next few months,” Smith said earlier this month.

The players

Despite their differences, PHEAA and Sallie Mae share similar histories, and both have significant political clout in Pennsylvania.

Northeastern Pennsylvania residents might be more familiar with Sallie Mae, because the company has had a loan-servicing center in Wilkes-Barre for 17 years. The company holds political sway in the region, because it is one of the area’s largest private employers.

Despite Sallie Mae’s national status, it’s the new kid on the block in Pennsylvania.

PHEAA was created in 1964 by act of the legislature as a way to help Pennsylvania’s students pay for their college education. The agency has grown from a small student loan guarantor in 1964 with a guaranty volume of only 4,600 student loans to one of the largest, full-service financial aid organizations in the nation.

Sallie Mae is slightly younger but has grown faster. It was created by Congress in 1972 as a government-sponsored program to service federal student loans and to encourage banks to participate in the federal loan program. Its assets have grown to nearly double that of PHEAA.

And Sallie Mae is no longer a government-sponsored organization. The company began privatizing its operations in 1997 and completed the process in 2004, severing all ties with the federal government.

PHEAA remains a nonprofit government agency. That remains PHEAA's No. 1 defense, and it has resonated with some lawmakers and Pennsylvania's college financial aid community.

The mudslinging

PHEAA and Sallie Mae have gone on the offensive, hiring lobbying and public relations firms to gain the support of the legislature and the public.

Allegations have been tossed around on both sides: Sallie Mae claims that PHEAA uses strong-arm tactics to corner the college loan market in Pennsylvania, and PHEAA alleges that Sallie Mae is solely out to make a quick buck at the expense of Pennsylvania's students.

The mudslinging has offended both organizations.

"There is no other way to characterize Sallie Mae's allegations than to say that they have been brazenly dishonest, which is a kind characterization since they have accused us of engaging in illegal activity," said PHEAA spokesman Keith New.

Referring to the claim of strong-arm tactics, New added, "More than one (House Appropriations) committee member criticized the irresponsibility of Sallie Mae for making such a strong allegation while offering no proof.

"Sallie Mae can say anything they want regardless of the facts. But the truth is echoed loudly by the schools and students we do business with who are offended by such underhanded tactics."

Sallie Mae Executive Vice President June McCormack, who oversees the Wilkes-Barre servicing center, was so incensed by PHEAA'S allegations that she took the opportunity to express her feelings at the House Appropriations Committee hearing in February.

"Our employees in Wilkes-Barre have been understandably disturbed at the way Sallie Mae's name has been dragged through the mud over these past weeks by individuals with a personal stake in maintaining the status quo regardless of the benefits that would accrue to Pennsylvanians from our proposed partnership," McCormack said.

"While our employees accept that reasonable people can differ about how best to run Pennsylvania's student loan program, they cannot understand, nor can I, why public money - their money, as taxpayers of Pennsylvania - has been spent on a media campaign designed to

convey negative impressions about the work that they so proudly perform on behalf of Sallie Mae, schools and students.

“As one of my Wilkes-Barre colleagues put it, ‘Every dollar spent attacking Sallie Mae is a dollar that cannot be used to help a young person in Pennsylvania pay for college.’”

PHEAA officials continue to hammer at Sallie Mae’s for-profit corporate status. New said PHEAA’s nonprofit status allows it to return much of its profits to Pennsylvania’s students through zero-fee loan programs and grants.

“By reinvesting our earnings back to students and families, we are able to offer the nation’s most responsive and affordable products and services,” New said. “Competition is fierce, so we have evolved to become a smart and lean entrepreneurial business that competes successfully against some of the largest and most aggressive for-profit corporations in the world.

“But unlike our competition, we don’t compete to enrich shareholders - we compete so Pennsylvania students, regardless of their social or economic circumstances, can achieve a college education and avoid unnecessary debt.”

In response, Sallie Mae officials say they are proud of their shareholders’ returns, adding that their public-company structure forces Sallie Mae to operate as efficiently as possible.

“We have shareholders, and we ought to be shareholder driven,” said Sallie Mae spokesman Tom Joyce. “PHEAA has shareholders, too. They just happen to be called taxpayers, and frankly they ought to be serving the taxpayers better than they are.”

Joyce said Sallie Mae has achieved its success through strong customer service, which in turn helps the company’s shareholders.

“It seems to me that we would not have gotten where we are without serving our customers and our students better than anybody else, and where we are is at the top.”

The true value

As the legislature weighs whether to sell PHEAA to Sallie Mae, some lawmakers have advocated that an independent appraisal be conducted to determine the true value of the agency’s loan business.

That is something Sallie Mae officials support, even if it means the price may rise above their original \$1 billion offer.

“We believe we made a fair offer, but in any transaction like this it behooves their shareholders, the taxpayers, to get someone with the expertise - in this case an investment bank - to get a fair market valuation,” said Joyce, Sallie Mae’s spokesman.

“We welcome having the independent analysis done; PHEAA does not. I’ll let that speak for itself.”

If an appraisal shows the true value of PHEAA to be greater than \$1 billion, Sallie Mae would be willing to look at the value to negotiate a fair price, Joyce added.

Bill Burke, financial aid director at the University of Scranton, said there is no purpose in getting an appraisal of PHEAA.

“I don’t think it’s worthwhile to pursue that value question if in fact it’s not a good idea to change. Would you determine the fair value of it? Yes. Would there be a purpose to that? No.

“There is no compelling reason to do this.”