Sheila Bair Called the Financial Crisis. Here's Her New Nightmare.

The former FDIC chief went up against Wall Street in 2006. To her, the nation's $1.4 trillion student debt is the disaster around the corner.

By Shahien Nasiripour | September 26, 2016

Photographs by Jared Soares for Bloomberg

Sheila Bair approached the podium in the downtown Renaissance Washington hotel ballroom to address the American Bankers Association for the final time as one of their most powerful regulators.

Arms crossed, brow slightly creased, Bair took the calm tone of voice of a frustrated teacher who had grown sick of her students' excuses.

During her five-year tenure chairing the Federal Deposit Insurance Corp., Bair had gone up again and again against bankers and lobbyists who resisted her attempts at imposing regulation. Even now in March 2011, with the economy still reeling from a crisis caused by bad loans, none of them wanted to listen.

“We need to get past rhetoric that … the best regulation is always LESS regulation,” she told the assembled bankers. Banks had put consumers at risk, she said, and now they faced a choice: to be viewed by history “either as a group that supported the restoration of free enterprise and public responsibility in the American economy, or as a group that mainly looked out for its own short-term interests and resisted reforms that could have restored a sense of confidence and fairness in our financial markets.”

Her audience squirmed. Then they heckled.

“If there was one meeting that I’ve had in my life that was uncomfortable, that one would have to be at the top of the list,” said Matt Williams, a Nebraska banker and state senator who then was vice chairman of the ABA. He remembers how Bair endured hostile questions. “She came in there to punch the bankers in the mouth.”

Last month–a little more than five years after that showdown–Bair arrived at her current office at Washington College in Chestertown, Md. It was the first day of classes and the start of her second academic year. In her new life as the first female president of the nation’s 10th-oldest college, she’s more likely to host a dozen freshmen for monthly “Pizza with the Prez” than face down a roomful of angry bankers.

But just as in 2006 at the FDIC when she foresaw the coming mortage crisis, Bair sees a potential financial catastrophe looming in her new industry—a generation of overly indebted Americans who will be too weighed down by debt to contribute to the economy, tanking it once again.

“In the aggregate, this is a huge problem,” Bair said.

She was stymied at the FDIC, but here she can do something—even on a small scale. So Bair has turned her campus into a laboratory. Her pioneering efforts to reduce student debt and make higher education more affordable could inspire other schools to do the same, said Larry Culp, chairman of the school’s board. “Other college presidents would study these issues endlessly,” Culp said. “She moved quickly.”

If Bair is successful, and other schools follow her lead, perhaps this time the crisis she foresees doesn’t have to become reality.

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Life got easier after leaving behind the mortgage crisis and its aftermath. Bair joined the Pew Charitable Trusts and sat on a few corporate boards, including that of Spanish banking giant Banco Santander SA, while fielding calls from headhunters. One day someone called with the chance to lead the University of Massachusetts system, a sprawling public network of more than 73,000 students and 17,000 employees in more than half a dozen cities. Bair interviewed but ultimately withdrew from consideration, she said, because she didn't want to move to Boston.

The idea of leading a college stuck with her, though. Her boss at Pew, Rebecca Rimel, told her that Washington College was looking for a new president. The school's size—it has less than 1,500 students—appealed to Bair, she said, because she could have an immediate impact and interact directly with students. Bair had the job within a few weeks.

But there was another reason why she wanted the gig.

In early 2014, Bair had set out to write a book, *Bullies of Wall Street*, explaining the 2008 financial crisis to young Americans. She wanted to warn tomorrow's adults against repeating the mistakes of today's.

In researching the book, she began to pay attention to student loans. Bair hadn't realized the extent to which Americans had loaded up on student debt in search of credentials in the aftermath of the financial crisis and were now struggling to pay it back.

Some 43 million Americans, she learned, collectively carry nearly $1.4 trillion in student debt, making it the second-largest source of household debt after home mortgages, according to the Federal Reserve. The federal government owns or backs more than 90 percent of it. More than 42 percent of federally owned student loans aren't being repaid as expected or on time.

Bair saw a lot about student loans and higher education that reminded her of the dodgy pre-crisis era mortgage market.

As in housing, cheap and freely available credit fueled rising prices, or in this case, tuition. Borrowers in both markets complained of shoddy customer service and an inability to strike deals with their loan servicers when they no longer could afford their monthly payments. Before the financial crisis, lenders frequently gave mortgages to borrowers who couldn't afford them. The same was happening with student loans.

Like the pre-crisis mortgage brokers who made money giving loans to borrowers who couldn't afford them, the U.S. Department of Education, which serves as the predominant lender to students, doesn't check whether borrowers will be able to repay their debt.

"A bank would never get away with what the Department of Education is doing," Bair said, though she also praised the department for some of its efforts. "There's no underwriting, and they let these kids get way in over their head on debt they possibly can't repay."

Meanwhile, borrowers are reporting that they're avoiding medical treatment, delaying marriage, and putting off homebuying on account of their student loans. Some student debtors say they've had trouble buying daily necessities such as groceries, and some researchers have linked the decline in new small businesses to the growth of student debt.

"It's a drag on the economy," Bair said. "It's money not being spent on building up savings, buying homes, or starting businesses. We all need to come to grips with that."

Bair decided that her next project would have to involve student debt. What happened before, she thought, could not be allowed to happen again.

The Washington College campus in Chestertown, Md.

Photographer: Jared Soares for Bloomberg

Bair's hometown of Independence, Kan., celebrates a few hometown heroes—among them, one of the first monkeys to go to space, and Bair. Bair's father was the only surgeon in town; both of her parents, staunch Republicans, were children of the Depression.

"My parents were cautious people," Bair said. "That risk-averse culture and prudence when it came to handling money stuck with me."

After law school and a stint at the Department of Education, she joined the staff of then-Senator Bob Dole. Her five years working for the Kansas Republican on Capitol Hill would propel her to positions on the

Commodity Futures Trading Commission, in the Treasury Department, and finally as chairman of the FDIC, one of the federal agencies that regulates the banking industry.

She took over the FDIC in June 2006, just a few weeks before national home prices would hit their all-time high. The country was in the middle of a long period of relative financial stability; as federal regulators relaxed standards, bankers created new products to disperse risk, and traditional financial companies and fly-by-night lenders alike could hand out mortgages to shaky borrowers without worrying much about eventual defaults.

In 2001, working for the Treasury, Bair had learned about predatory lending practices in Baltimore that led to borrowers losing their homes. Neither Congress nor regulators were prepared to put a stop to suspect practices, so Bair tried to persuade lenders to agree voluntarily to stop offering mortgages that stripped borrowers of their home equity. It went nowhere.

That kind of lending continued well into 2006, when Bair, within a few months of joining the FDIC, began publicly to sound the alarm about dangerous mortgages. In September 2006, she warned the financial industry about the "troubling" proliferation of a type of adjustable-rate mortgage that allows borrowers to make monthly payments that don't even cover the accumulating interest. "There are indications that less sophisticated borrowers simply do not understand the complex terms involved," Bair said then.

"I constantly think back and wonder, Could I have done something different?"

Once again, U.S. regulators did little to stem the problem. Risky lending continued. By the time they finally demanded that lenders cut it out, there wasn't time to reverse the damage. Borrowers began defaulting at record levels.

Over the next few years, Bair focused much of her attention on changing the terms of existing mortgages. If millions of borrowers were falling behind on their loans, the key to stopping foreclosures was to modify their mortgages, she thought. She advocated for a simple program designed to cap borrowers' monthly payments relative to their incomes.

Senior officials in both the Bush and Obama administrations paid little attention to her pleas. The Obama administration enacted a mortgage modification plan based on her proposal, but the plan was too complicated, too small, and too reliant on loan companies to halt home repossessions meaningfully. Millions of Americans lost their homes. The nation's homeownership rate now is at its lowest since 1965, according to the Census Bureau.

"I wish they would've listened and acted sooner and with more conviction," Bair said. She gets depressed when she talks about loan servicing, or the business of collecting borrowers' monthly payments and counseling them on their options when they no longer can afford their mortgages. "I constantly think back and wonder, Could I have done something different?"

Washington College's board wanted a nontraditional candidate who would put the school on the map, Culp said. With Bair, they got one.

"She helped lead the fight for reform during the financial crisis, and now she's out there calling for real accountability in higher education," said Senator Elizabeth Warren (D-Mass.). "Sheila is independent and tough and always ready to speak up when she sees problems that need to be fixed."

When Bair met with board members in the spring of last year, before she was hired, she described the similarities she saw between student debt and the housing crisis that nearly destroyed the U.S. economy. Bair pitched them on making Washington College more affordable. But she didn't have a defined plan. "Sheila has been thinking about these issues longer than she's been a college president," Culp said.

Launching a new scholarship would help incoming students, but it would take some four years before they saw results. Bair wanted to reduce debt levels immediately. During one of their weekly brainstorming sessions with a working group she convened to tackle student debt, someone mentioned the idea of giving grants to graduating students—like a back-end scholarship. In addition to reducing debt, it could motivate students to graduate. Bair loved the idea.

The school couldn't afford to fund the grants out of its existing budget, so Bair decided to fund the initiative with donations. She'd call it "Dam the Debt."

Less than two months after starting at Washington College, Bair announced Dam the Debt during her inaugural address on Sept. 26. She also changed an internal policy that now directs all unrestricted donations to student scholarships. Most major gifts last year were used to cut students' tuition bills.

This past spring, 119 graduating seniors received nearly $2,640, on average, as part of Dam the Debt. Funded by donors, the grant reduced recipients' federal student debt loads by more than 10 percent. Bair hopes the initiative eventually will reduce student borrowing by at least one-third.

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Bair also worries that the federal government's system to fund higher education pushes students and their families to borrow rather than save. For example, if a student earns income from a summer internship, his financial aid the following year could be reduced.

Last month, after making sure the school could afford it, Bair announced what she called the Saver's Scholarship to reward families for saving for their children's college education. It would annually shave up to $2,500 off students' tuition bills if part of their payments come from tax-advantaged college savings plans.

Although the plan inevitably will help high-income households, since they're the ones who typically sock away money in tax-advantaged college savings plans, Bair said she's fine with that. Everyone but the truly rich struggles to pay for college, she said, especially upper-middle-class households with multiple kids. She hopes to solicit donations to fund it in future years.

"You may make $150,000 a year, but if you have a few kids, you're going to have a heck of a time paying for college," Bair said. "I wish the federal government would decide whether they want families to save or not."

Bair has other ideas, too. She froze tuition last December, and the school is considering extending the freeze for four-year periods, so that an entering class of freshmen wouldn't have to worry about annual cost increases. Washington College also is looking at "income share agreements," or ISAs. Typically funded by private investors, ISAs let students borrow money to attend college and then pay it back with a set percentage of their yearly post-college wages. A student who ends up earning little would pay little. Students who land high-paying jobs would pay more.

The ISA idea came from Purdue University President Mitch Daniels, who is also looking into ways to lower his students' costs. Like Bair, he has also instituted tuition freezes, as well as striking an agreement with Amazon.com for cheaper textbooks. Purdue's students now pay less to attend than their predecessors paid during the 2012-13 academic year.

But Bair wants to tweak the ISA concept. Instead of tapping private investors, she would like to solicit donations and establish a fund that students could dip into to pay for classes. Then, after graduation, monthly payments from those same former students would replenish the fund, making money available for future students.

It's not clear if the modified ISA plan will go into action. But the school has big plans: Bair wants Washington College to be thought of as a top-50 liberal arts school within five years. Culp would like to see the school increase enrollment by close to 20 percent over the next decade, while still keeping the number of students per faculty member at 12:1.

In the short time Bair has been at Washington College, her initiatives are already having a visible impact. The proportion of alumni donating money to the school has increased by four percentage points, she said. More freshmen returned for their sophomore year. And last year the school raised a record $23 million.

Washington College's convocation on Sept. 1.

Photographer: Jared Soares for Bloomberg

Bair is not the only one tackling the problem of student debt. The White House, under President Obama, pushed the U.S. Department of Education to create the College Scorecard, a website where Americans can easily check colleges' affordability and how their typical federal student aid recipient fares after leaving school. It also includes earnings information gleaned from federal tax records, in the hope that college-goers will be more discerning. The Obama administration and various regulators also are targeting schools that allegedly defrauded their students. Rules on colleges' access to federal aid are being tightened, too.

But there's a lot more left to do. Bair hopes to be an example for the industry, but at the same time, she risks upsetting prominent colleges with her views. Some rich schools are too stingy, she believes. Bair supports a proposal that would almost certainly require the wealthiest nonprofit schools to devote up to 25 percent of their endowment income to students' financial aid. If Washington College had a billion-dollar endowment, Bair told Congress on Sept 13, she'd slash tuition by up to 80 percent. "Higher education faces a bit of a reckoning," said Culp.

But higher education is a powerful lobby with lots of friends. Much of Congress already is trying to reverse some Obama administration rules that tightened oversight of the sector. Bair often has been an outsider. “I've never really felt like I was part of the club,” she said. Still, she can't help but speak out, just as she did during her time at the FDIC.

“We are not doing these young people any favors by giving them loans that they cannot afford, that they cannot discharge in bankruptcy, and that could be a drag on their financial well-being even into retirement,” she said at the Sept. 13 congressional hearing.

Bair's testimony was received very differently from the speech she'd given to the bankers back in 2011. This time, no one heckled her. Instead, legislators wanted to know how she'd accomplished all she'd done.

"We have a lot of universities that say ... they find it as a victory to only increase tuition by 5 percent a year," Representative Jason Smith (R-Mo.) said. "And you have frozen it. Can you tell us how you've done that, when so many others say it's impossible?"

Representative Patrick Meehan (R-Pa.) asked Bair to expand on her past remarks "paralleling the mortgage crisis to the education crisis," as he put it.

"The problem is much worse," Bair replied. "The percentage of [former] students in distress on their student loans is significantly higher than we saw during the subprime crisis."

In many ways, the interest of lawmakers in what Bair had to say might be one of the more significant differences between the two crises.

Williams, the Nebraska lawmaker and banker who was in the Renaissance Washington hotel ballroom for Bair's 2011 speech to the ABA, now says that his industry would have been much better off had various measures Bair championed before the crisis been implemented sooner and more aggressively. “That would have changed a lot of lives, wouldn't it?” he said.

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