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Short sellers flag school stocks

By: Chris Frates
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Investors who make money by betting against troubled companies have started warning lawmakers that the for-profit higher education industry is abusing federal student aid to make a profit. But critics argue the so-called short sellers are only trying to smear the industry's reputation in a bid to drive its stock prices down.

Two renowned short sellers have been lobbying lawmakers and administration officials, warning that for-profit schools are positioned for the same kind of crash that recently hit the subprime mortgage industry.

Steven Eisman, a hedge fund manager who shorted the subprime mortgage market, testified before a Senate committee last week. And famed short seller Manuel P. Asensio's new nonprofit group has written to Education Secretary Arne Duncan, asking him to investigate the business practices of a for-profit education company.

The Wall Streeters say the for-profit education industry's growth has been fueled by government-backed student loans. Since students and the government, not the schools, bear the risk of default, for-profit colleges have every incentive to enroll as many students as possible, regardless of their ability to repay the loans, they argue.

Even worse, they say, the schools target the poorest Americans by promising a path to prosperity only to leave them with a subpar education that will not help them secure the better-paying jobs necessary to repay their student loans.

"Without the scam on the DOE, for-profits would not exist," Asensio said in an interview. "It's the worst product at the highest price." He said the for-profits get the least-educated people, "who are most susceptible and are least capable of analyzing what they're buying, to get on board."

Asensio is president of the nonprofit, nonpartisan group Alliance for Economic Stability, which is aimed at creating a fair financial marketplace. He said he has never shorted the for-profit education industry. But, he said, he understands why some of his colleagues would.

"We don't see any redeeming value for the for-profit education stocks," Asensio said. "There's no reason for them to exist."

Eisman used similarly strong language, telling a Senate panel that the industry was "as socially destructive as the subprime mortgage industry" — and was sharply criticized for using his testimony to degrade the same industry he was betting against.

At the hearing, Eisman acknowledged that he has a financial stake in the industry and told

Senate Health, Education, Labor and Pensions Committee Chairman Tom Harkin, "The reason why I'm here today is that it's my hope that there's still time to do something."

"I don't have an interest in them failing," Eisman continued. "There are very bad things going on in this industry. I think there's some very bad actors, and things should be done with that."

Short sellers make money by borrowing and then selling assets they think are overvalued, waiting for their value to decline before repurchasing them at the lower price and selling them back to the lender. The short seller pockets the difference between the higher sale price and the lower repurchase cost.

Eisman's congressional appearance raised industry hackles even before he uttered his first words.

Harris Miller, president of the Career College Association, called Eisman "a Wall Street short seller born with a silver spoon in his mouth, who got his first big paycheck the old-fashioned way, through his parents."

Miller's pre-hearing statement predicted Eisman's testimony would include "self-serving attacks on nontraditional students designed to fatten his wallet."

And in an interview, Miller also said he is "skeptical" of Asensio's claim that he has no financial interest in the industry.

"I don't understand how somebody who makes money by making money gets involved in an issue he has no interest in," he said.

And the progressive group Accountable America said Eisman's testimony made the hearing look like a "scam."

"Inviting Eisman to a HELP committee hearing on a sector he is short selling is like asking an arsonist whether a building will burn down. He'll say, 'yes' but that is because he plans to burn it down," said Tom Matzzie, the group's chairman.

Miller defended the industry, saying for-profit schools are helping to meet demand at a time when states are cutting back funding for community colleges and public universities.

The nationally accredited schools, he said, are highly regulated and risk losing their access to federal student aid if they don't meet graduation and job placement rates.

And then there's the invisible hand of the market to contend with, he said.

"If you're consistently underperforming, in terms of education and placement, students will not enroll," Miller said.

Democratic Rep. Robert Andrews said he is working on legislation that would create an education quality index to measure the performance of for-profit and traditional schools alike.

The measure would rate schools on three metrics: graduation rates, the number of students who found work in the field they studied and the percentage of students repaying their loans. It would be weighted to give an advantage to schools that enroll more low-income students, he said.

Schools that do a poor job — whether for-profit or nonprofit — would lose federal student assistance money, the New Jersey congressman said.

Andrews also seemed to question the short sellers' sincerity, noting that he has never seen a similar crusade to protect taxpayers in other controversial policy areas. Indeed, he said, a casual investor probably would avoid investing in an industry that's being examined by Congress.

Short sellers, he said, "can create a kind of self-fulfilling prophecy where you testify in front of a congressional committee, that makes people skittish and drops the stock prices — which is what you want. I have a concern about that. You can't play in the game and influence the outcome of the game when you're short selling."