The College Loan Landscape: An Overview of How the U.S. Federal and Private Student Loan Programs Operate

The Federal Student Loan Programs: How They Operate

The U.S. Department of Education operates two federal student loan programs: the Federal Family Education Loan Program (FFELP) and the Direct Student Loan Program. Loans offered through the two programs carry the same interest rates, terms and conditions for borrowers, and are generally much cheaper than private college loans.

Under FFELP, the federal government guarantees and subsidizes the loans that lenders issue to students and parents. There are currently more than 2,000 lenders participating in FFELP; the program's loans account for 80 percent of all federal college loan volume.

Under the Direct Student Loan program, the federal government offers the loans directly to students, securing loan capital from the U.S. Treasury. Currently, Direct Loans account for about 20 percent of all federal college loan volume.

It is up to colleges and universities to determine which federal college loan program they will participate in: FFELP, the Direct Loan Program, or both.

Almost 1,200 schools currently participate in the Direct Loan Program. An additional 750 schools are currently approved and signed up to participate, but are not actively issuing Direct Loans. Almost 6,000 schools are currently using the FFELP for federal student loans.

The Differences between Federal and Private Student Loans

In addition to federally guaranteed college loans, some lenders also offer private (or "alternative") college loans directly to borrowers. Private loan volume has grown significantly in recent years. According to the College Board, during the 2006-2007 school year, private college loans accounted for 24 percent of all education loans, and private loan borrowing increased by 12 percent among undergraduates in 2006-2007.

Unlike federal loans, which have fixed interest rates of 6.8 percent, private college loans can carry interest rates as high as 19 percent, and also carry different terms and conditions than federal loans.

According to the Consumers Union, nearly 50 percent of undergraduate private education loan borrowers fail to exhaust their low-cost federal government loans before turning to more expensive private loans to pay for college. The research showed that students and parents often could not identify the best priced loan and that private loan lenders do not always adequately disclose important terms and rates that families need to compare loan options.

The Lender-of-Last Resort Program: A Nationwide Network of Backstop Lenders

The Higher Education Act allows the U.S. Secretary of Education to designate the 35 guaranty agencies around the country as "lenders of last resort." Guaranty agencies are state agencies or non-profit agencies that work with schools and borrowers to help administer the FFELP.

Under existing law, these guaranty agencies are obligated to serve as lenders of last resort to avert any possible problem in access to student loans, thereby providing a nationwide network of backstop lenders. As part of their contracts with the Department of Education, guaranty agencies are required to already have rules and procedures in place for a lender-of-last-resort program.

Eligible lender-of-last resort providers include state guaranty agencies; a lender that is an agency of the state, or a nonprofit private agency designated by the state; or any eligible FFELP lender that works with guaranty agencies or state lending agencies.

Lenders that participate in the lender-of-last resort program would be eligible for 100 percent insurance on those loans (compared with 97 percent insurance on federal college loans).

If guaranty agencies or other lender-of-last resort program participants had trouble accessing capital to finance lender-of-last resort-loans, the Secretary has the authority to advance federal funds to guaranty agencies to make these loans.

In the place of the traditional interest payments lenders receive under FFELP, guaranty agencies serving as a lender-of-last resort would be paid a fee established by the Secretary for making such loans.

The Education Department had established a lender-of-last-resort plan in 1998. The Department never needed to implement the plan.

How Would the Lender-of-Last-Resort Program Work?

Currently, a student is eligible to receive federal Stafford loans under the lender-of-last-resort program if that student is eligible to participate in the FFELP, and meets all of the following conditions:

- The student qualifies for a subsidized (or need-based) Stafford Loan;
- The student is eligible for a combined subsidized and unsubsidized (non need-based) Stafford loan amount of at least $200;
- The student is otherwise unable to obtain loans from another eligible lender and the borrower can show that two lenders have refused to make the borrower a loan.

Lenders-of-last-resort may also provide unsubsidized Stafford loans and PLUS loans to any eligible borrowers who have otherwise been unable to access those loans from a FFELP lender.

Under the plan developed by the Education Department in 1998, the Department had developed procedures to simplify the process for borrowers, making the process school-based, rather than borrower-based. Rather than requiring borrowers to individually prove that they were turned down by two lenders, the Secretary would have designated an entire school as a lender-of-last-resort school. Eligible borrowers attending such a school would automatically be eligible for lender-of-last-resort loans.