HILDRETH INSTITUTE

PRIVATE STUDENT LOANS

The riskiest way to finance college is becoming the last resort for too many students.

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EXECUTIVE SUMMARY

- Private student loans are riskier than government-issued federal student loans, yet college students continue to borrow large amounts of private loans.
- Since 2005, when private student loans were declared non-dischargeable in bankruptcy proceedings, the private student loans industry has grown 50 percent. This regulatory change made issuing student loans much more lucrative and far less risky for private lenders.
- In the last decade, the dollar amount of private student loans borrowed by freshmen increased 38 percent.
- Studies show that private student loans are not well-understood by students, who likely confuse them with the less risky government-issued federal student loans that come with low-interest rates and flexible repayment plans, including forgiveness clauses.
- For borrowers, however, high interest rates and fees, lack of flexibility in repayment terms, and non-dischargeability in bankruptcy make private student loans especially risky.

- The federal CARES Act stimulus package, passed in response to the COVID-19 crisis, offers no relief for private student debt holders and exacerbates their financial burden.
- The CARES Act exclusions also expose the confusion among borrowers uncertain whether their student loans qualify for automatic suspension of payment or not.
- The government must end this confusion and the serious financial struggle facing borrowers holding private debt by ensuring relief is extended to all student debt holders, regardless of loan types.
- The current health crisis and its economic impacts spotlight not just how financially vulnerable student debt has made us, but also how disproportional the vulnerability has become. It is time we seriously question our heavy reliance on student loans and dare to imagine an equitable way to finance higher education.

TALES OF RISK FORETOLD

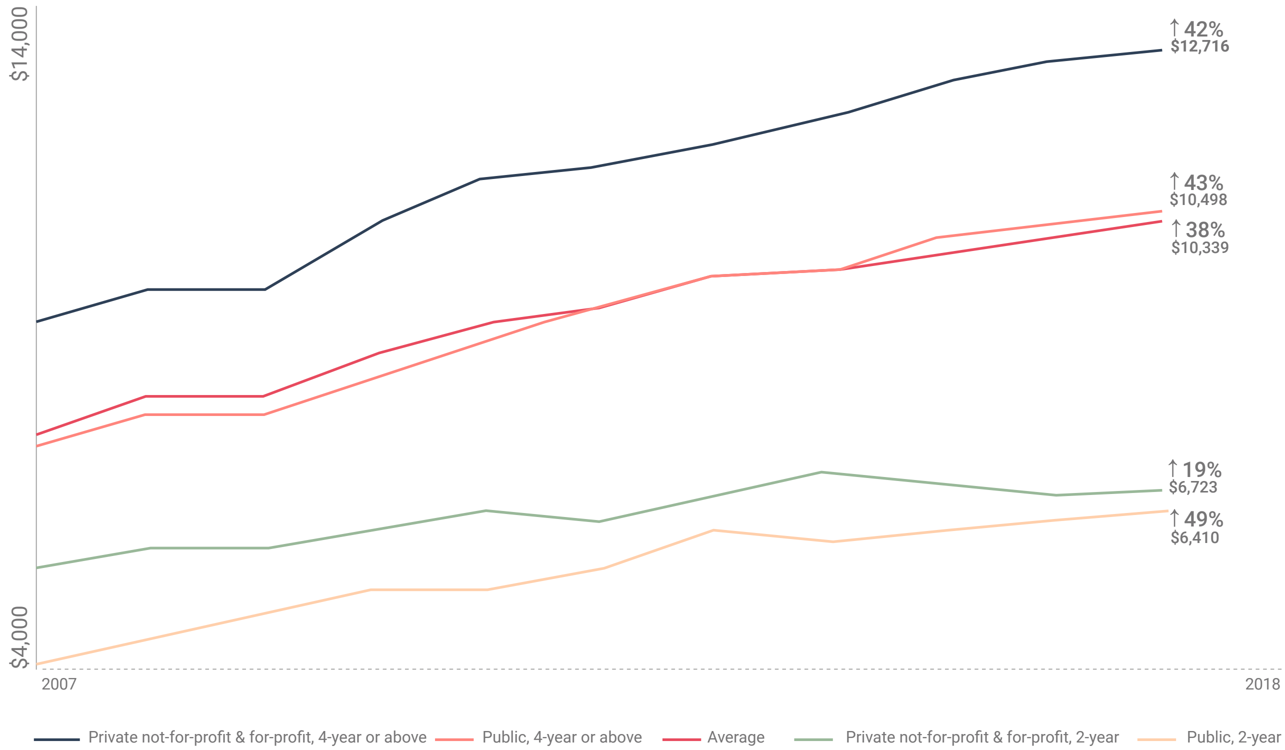
Most of us are familiar with the notion that the federal government issues subsidized low-interest loans for students to financially assist them to cover college costs. Less well-understood are the private student loans made available by various private financial institutions. Students are often unaware that there are significant differences between government-issued federal student loans and the private ones.

At the start of 2019, private student loans made up about 7.7 percent ($123.14 Billion) of the total $1.59 trillion outstanding student loans volume. While the value of federal student loans eclipse that of privately-held student debt, several startling trends have emerged.

STUDENTS ARE BORROWING HIGHER AMOUNTS OF PRIVATE LOANS TO FINANCE THEIR HIGHER EDUCATION

Among full-time, first-time undergraduates who resort to private loans, the average amount borrowed has steadily increased since 2007, by 38 percent across the higher education sectors.

AVERAGE AMOUNT OF PRIVATE STUDENT LOANS AWARDED TO FULL-TIME FIRST-TIME UNDERGRADUATES BY SECTORS OF HIGHER EDUCATION



Source: Graph generated by the author using data from the National Center For Education Statistic - Integrated Postsecondary Education Data System - NCES-IPEDS

While freshmen in 2007 borrowed an average of $7,000 to $8,000 to pursue a 4-year degree, they now borrow 43 percent more, $10,000 to $12,700. Similarly, freshmen at public community colleges now take out $6,400 on average, 49 percent more than the $4,300 they borrowed in 2007.

Students are borrowing larger amounts of private student loans for several reasons. One is the increasing cost of college. As students reach their federal loan eligibility caps, they turn to private sources of financing to bridge the gap between what they can borrow from the federal government and what colleges charge in tuition. But the tuition gap alone is not the full story. A 2019 study by the Institute for College Access & Success (TICAS) reveals that 53 percent of students borrowed less in federal loans than they qualified to borrow.

More than half of students took on debt that was not only more expensive than Stafford Loans, but which offered no leniency in case of financial hardship. This behavior suggests that the majority of students did not receive adequate advising about financial aid eligibility and options. It also hints that private lenders are successfully deploying expensive and aggressive marketing campaigns, making their lucrative student loan products more visible and accessible to cash-trapped students than the federal government does for its own loans.

PRIVATE STUDENT LOANS HAVE GROWN INCREASINGLY LUCRATIVE FOR LENDERS BUT RISKIER FOR BORROWERS

The private student loan industry enjoyed 50 percent growth after 2005, when a regulatory change made private student loans non-dischargeable in bankruptcy. With borrowers essentially unable to erase their private student debt, even in bankruptcy, financing higher education became more attractive to private lenders. Less concerned about borrower ability to repay, private student loan providers became more willing to extend large amounts to anyone seeking higher education credentials.

The lack of consumer protections and regulations governing the private student lenders is also alarming. Data shows that the largest percentage of complaints related to dealing with the lender or servicer comes from private student debt holders. According to the Consumer Federal Protection Bureau (CFPB) 2018 data, private student debt borrowers are six times more likely to file a complaint than Federal student loan holders.

While federal student loans are not automatically discharged in bankruptcy, they are regulated to protect borrowers in ways that private loans are not. The most widely used federal student loans, Stafford Loans, come with many perks that mitigate risks for borrowers. First, Stafford loans come with maximum eligibility caps, which prevents students from overborrowing. Second, they are subsidized with fixed low-interest rates and low fees. Third, borrowers have access to various income-based repayment plans, unemployment deferment or forbearance possibilities, and for those who qualify, generous forgiveness options.

In contrast, private student loans come with variable interest rates, no subsidies on interest, inflexible repayment options, and no forgiveness. Private lenders may charge whatever interest rate students are willing to pay, charging as much as 14.24 percent in April 2019.

While the federal loan system is complex to navigate and in need of simplification, federal loans allow borrowers to stop making payments when financially burdened. Holders of private student debt lack such options during similar struggles. Regardless of their economic situations, borrowers have to repay their private debt on the lenders' terms or face default.

Furthermore, private lenders often require student borrowers to have a cosigner. Because private loans are non-dischargeable, both the borrower's and the co-signer's credit scores suffer if financial difficulty lands them in bankruptcy court. Both borrowers and co-signers can thus encounter higher interest rates on other forms of consumer credit like credit cards, auto loans, or mortgages, and higher interest rates on existing debts.

	Federal Student Loans	Private Student Loans
Lender	Federal Government	Private banks or private financial institutions
Sets a max loan limit	Yes	No
Interest	Fixed - low	Variable - High
Fees	Low	High
Subsidized	The government pays the interest of students with financial need while they are still in school	No
Credit Check	No - Minimal for Parent Plus loans	Yes
Co-signer	No need	Need a co-signer often
Repayment start	Deferred	Immediate
Repayment options	- Fexible - Income-based plans - Deferement and Foreberance options	- Little flexibility. - Varies by lenders but typically standard repayment
Option to pause	Deferred repayment in unemployment and hardship	No
Forgiveness	Yes, available for public servents, teachers, and for some in income based-repayment options.	None

VULNERABILITIES EXPOSED IN PANDEMIC'S HARSH GLARE

The current COVID-19 health crisis reveals yet again how confusing the student loan landscape is for borrowers. The CARES Act stimulus package provides automatic suspension of student debt repayment only for government-held Direct Stafford Loans. Private student loan borrowers have to continue making regular payment on their debt, or watch their interest accrue, even if they lose income or employment during this pandemic[1]. The CARES Act shows once more that private student loans lie beyond the government's reach. Left unregulated, private lenders continue to profit from lucrative loan terms and protection from discharge should their borrowers go bankrupt.

For years, private student loans have been deemed a risky way to finance higher education. Advocates and policymakers have warned about the lack of options and adequate protections available for struggling borrowers. These efforts have increased public awareness about differences between private and federal loans, and the impact private loans' variable interest rates have on borrowers' overall debt. Several lawsuits have pressured private lenders to improve their practices and stop predatory marketing. But more needs to be done.

[1]Commercially-held federal loans (referred to as Federal Family Education Loans) and Perkins Loans were not included in the CARES Package as well (see more on this issue below).

Commercially-held federal loans (Federal Family Education Loans) and Perkins Loans were excluded under the CARES Act. In a recent letter, Hildreth Institute joined 25 organizations, to urge Congress to extend CARES Act protections to holders of these loans. We are glad that our demands were heard and that a bipartisan bill was proposed, the Equity in Student Loan Relief Act. If passed, it will extend relief to an additional 9 million borrowers.

However, this proposal will still not include any relief for private student debt holders. It is clear the federal government exercises no oversight over private lenders, even while granting them the privilege to be on the list of education loans that are non-dischargeable in bankruptcy. While we celebrate the proposed expansion, we argue that true equity in relief must include private student loan borrowers.

Therefore, applaud the efforts of a nine-state initiative to secure relief options for borrowers with twenty private student loan servicers. In California, Colorado, Connecticut, Illinois, Massachusetts, New Jersey, Vermont, Virginia, and Washington, borrowers struggling to make loan repayments due to the public health crisis may be eligible for relief not provided under the CARES Act. Now, consumers in those states with certain commercially-owned federal or privately-held loans may qualify for new forbearance repayment options. However, this relief is neither automatic nor comprehensive. Borrowers are asked to continue making payments until they've negotiated actual terms of relief with their loan servicers. With call centers swamped by inquiries, borrowers may experience long delays in reaching their loan servicers. Furthermore, not all loan servicers are participating in this relief agreement. Residents of these nine states may connect with their loan servicers and find their loans still don't qualify.

Negotiating one's own terms of relief requires sufficient knowledge of one's loans and ability to advocate for one's self. At a time when borrowers are isolating at home, caring for family members, navigating remote work or school, or adjusting to complete loss of income, securing student debt relief may be much more challenging for some individuals than for others. Thus, we must urge Congress to expand the automatic relief provided by the CARES Act to all student debt holders, regardless of the types of loan they hold.

The current health crisis and its economic impacts spotlight not only how financially vulnerable student debt has made us, but also how disproportionate the vulnerability has become. It is time we seriously question our growing reliance on student loans and dare to imagine an equitable way to finance higher education.

ABOUT THE HILDRETH INSTITUTE

The Hildreth Institute is a research and policy center dedicated to restoring the promise of higher education as an engine of upward mobility for all. Education is the key to unlocking opportunity.We believe that all students should be able to obtain a high-quality, zero-debt postsecondary education.

We research, develop, and promote solutions for changes in public policies and institutional financial practices that will reduce costs to students and improve quality. Through partnerships with researchers and policy experts, with politically diverse organizations, with policy makers from both major political parties, and with corporate and community leaders, we will build support for transformative change in higher education financing.

ABOUT THE AUTHOR

Bahar Akman Imboden is an experienced research professional interested in issues related to social justice and development. She holds a Ph.D. in political science from McGill University. After working on various research projects in international development and peace-building, Bahar co-founded 'Socially Responsible Research' a consultancy partnership offering evaluation and research support to nonprofit organizations. Working closely with Inversant, she developed a keen interest in the US higher education system and how it relates to the pervasive inequalities present in our society. Bahar is thrilled to lead Bob Hildreth's new initiative, the Hildreth Institute, where we seek to fight for an equitable and more sustainable higher education system that benefits all.

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