Banks and other financial institutions make private student loans without any direct financial backing from the federal government. Private loans are also known as private-label or alternative loans. Private loan issues are discussed in detail in Chapter 12 [1], infra.

The private student loan industry grew throughout the 1990s and early 2000s. Unfortunately, many of the lenders targeted low-income borrowers with subprime loans. Too many of these risky, high-cost loans were destined to fail and did fail at astronomical rates, especially after the economic crisis. Many lenders targeted for-profit school and low-income students with the most expensive products.

As the credit crisis hit, lenders began reporting huge increases in delinquency and default rates. Few lenders have stepped up to offer relief for these borrowers.

Since the financial crisis of 2008, most private student lenders still in business have adopted more responsible business models. For example, lenders have tightened credit standards and reduced lending to nonprime borrowers. There is no guarantee, however, that this safer market will persist. The Consumer Financial Protection Bureau (CFPB) has stated that lenders’ appetite for risk tends to ebb and flow, and there is no assurance that, as the memory of the financial crisis fades, lenders will continue to stick to responsible lending.

Both federal and private loans can be used only to help finance postsecondary education and can be certified only up to a certain amount. For private loans, this amount often is either a set dollar amount or the cost of attendance minus aid, whichever is less. In contrast, most federal loans have legal amount limits.

A critical difference between federal and private loans is the lack of certain protections for private loan borrowers. For example, students with private loans are not eligible for the same types of discharge options discussed in Chapter 10 [2], infra. The same is true with regard to deferment and forbearance rights, all of which depend on the lender’s policies and the terms of the loan contracts rather than on federal regulations. Similarly, borrowers of private loans will not have access to the same income-driven repayment plans and related loan forgiveness that exist for federal loans.

Private loan terms and conditions, including interest rates and fees, are generally determined by an individual’s or a co-signer’s credit history. Thus, low-income students and/or those with negative credit histories are more likely to receive loans on less favorable terms. Federal student loan borrowers, in contrast, must meet eligibility requirements but generally do not have to prove creditworthiness. All eligible federal loan borrowers are subject to the same rules regarding interest rates and other terms.

On the other hand, there are certain advantages for private loan borrowers. Unlike for federal loan collections, there should be a statute of limitations for the collection of private loans. Additionally, private lenders have fewer collection tools than the federal government. One earlier advantage of private loans has been lost: previously, private loan borrowers were generally able to discharge their loans in bankruptcy. Due to changes in the bankruptcy law effective October 2005, the bankruptcy rules are now generally just as restrictive for private loans as for government loans.

Finally, there are numerous claims that can be raised against private student lenders, such as those under the Truth in Lending Act, which are not available against federal lenders. However, some laws, such as the Fair Debt Collection Practices Act, apply equally to federal and private loans as long as third-party debt collectors are at issue. As a threshold matter, practitioners must determine whether a particular student loan was made or guaranteed by the federal government or originated by a private lender. That issue is discussed in § 12.2.2 [3], infra.

Footnotes


294 [294] See § 2.2 [6], infra.

295 [295] See § 12.7 [7], infra.

296 [296] See § 3.3 [8], infra.

297 [297] See § 1.6 [9], supra (federal loan eligibility requirements). PLUS loan borrowers, however, are required to meet certain creditworthiness standards.

298 [298] See § 12.8.5 [10], infra.

The elimination of the statute of limitations in the Higher Education Act applies only to federal loans. 20 U.S.C. § 1091a. See § 8.5.3.2 [11], infra.

299 [299] See § 11.2.3.4 [12], infra.

300 [300] See §§ 12.4 [13], 12.8 [14], 14.2.2 [15], infra.


Source URL: https://library.nclc.org/sl/0108

Links
[1] https://library.nclc.org/nclc/link/SL.12
[3] https://library.nclc.org/nclc/link/SL.12.02.02
[6] https://library.nclc.org/nclc/link/SL.02.02
[8] https://library.nclc.org/nclc/link/SL.03.03
[9] https://library.nclc.org/nclc/link/SL.01.06
[10] https://library.nclc.org/nclc/link/SL.12.08.05
[11] https://library.nclc.org/nclc/link/SL.08.05.03.02
[12] https://library.nclc.org/nclc/link/SL.11.02.03.04
[14] https://library.nclc.org/nclc/link/SL.12.08
[15] https://library.nclc.org/nclc/link/SL.14.02.02