# Challenges for Students, Taxpayers, and Institutions under the former Federal Family Education Loan Program

## Federal Family Education Loan Program (FFELP)

Congress terminated the Federal Family Education Loan Program (FFELP) in 2010, transitioning all federal student loans to the Direct Loan program (DL). The Higher Education Loan Coalition advocates for continued progress and improvement to the existing DL program. As outlined below, FFELP resulted in higher costs for students and taxpayers, poor loan servicing, ethical issues, and a greater administrative burden for institutions.

### *Higher Costs for Students and Taxpayers*

- Because of taxpayer subsidies paid to private lenders (to encourage them to make uncollateralized loans to borrowers without regard to credit history that do not require repayment for extended periods of time), **private education loans will always be more expensive to taxpayers** than government-made loans.
- The Congressional Budget Office (CBO) calculated **significantly higher subsidy rates - meaning greater cost to taxpayers** - in FFELP than in DL, throughout the time that the two programs ran concurrently. CBO estimated the cost to be as much as $0.17 per $100 loaned *higher* in FFELP than DL.
- The opportunities provided to institutions through the School-As-Lender program in FFELP **allowed schools to make profits from their students' borrowing**. Schools made federal loans to students, sold those loans to other FFELP lenders, typically turning a quick profit. The more schools encouraged their students to borrow, the more money they could make.
- Some FFELP lenders knowingly took advantage of an obscure and supposedly temporary allowance in FFELP, extending an exorbitant 9.5% subsidy rate on loans they "recycled" through what they perceived as a loophole in the law. Until Jon Oberg, former Department of Education research, sued these lenders as a private citizen, this nefarious activity continued and **cost taxpayers billions** of unnecessary dollars in excess profits paid to FFELP lenders.[1]
- Some lenders sold their loans to third parties who serviced the loans. Other lenders held their loans and billed students themselves. Borrowers had a very difficult time keeping track of their loans - who owned them and who serviced them. As a result, **defaults were higher in FFELP than DL**.

### *Poor and Inappropriate Loan Origination and/or Servicing*

- FFELP loan servicing was **inconsistent**. While some servicers did an excellent job, many others did not, offering poor customer service.
- FFELP lenders **treated some borrowers better than others**. For example, students at more prestigious schools were often offered better interest rates, lower fees, and greater discounts in repayment.
- Funding was not always consistently available for lending to students in FFELP. Lenders might drop out of participation one year and reenter in another, or have insufficient capital to continue lending even to prior

[1] *United States of America, Ex Rel. Jon H. Oberg v. Nelnet, Inc. et al.* (2007)

customers/borrowers. As a result, especially in the final years of FFELP, the market was **inconsistent**, **volatile**, and **unpredictable** for student borrowers and schools.

- FFELP gave rise to guaranty agencies who managed payments to lenders for defaulted loans. However, in the later years of FFELP, the agencies' function became **irrelevant and unnecessarily costly** as the federal government no longer needed them – and yet they continued to exist in statute and cost taxpayers more money.

***Ethical Issues***

- The largest FFELP lender gave "free" front desk help to some schools' financial aid offices who then **promoted that lender's products**, bolstering their federal and private loan volume.
- To increase sales, some **lenders created conflicts of interest with inappropriate incentives** for the financial aid officers at large volume schools. Among other flagrant issues, one lender gave a director and his wife an all-expense paid trip to Paris; another lender paid for a director's doctoral program.

***Administrative Burden for Institutions***

- Under FFELP, schools were forced to manage the paperwork and administration of student loans originated by hundreds of lenders who had **different requirements, processes, and timelines**. This necessitated significant **staff hours** and higher **personnel costs** to run FFELP at the institutional level.

## Financial Aid Directors Respond to HELC Survey on Direct Loans

In January 2017, HELC surveyed over 5,800 Financial Aid Directors about their experience with the Direct Loan Program and implications for the students they serve. Respondents represented all sectors of the higher education community and 75% of those responding moved to Direct Lending because of the elimination of the federal bank-based program.

***Key Findings***

With a significant response rate of 15%, the survey indicated the following:

- 88% of respondents reported that their expectations were met or exceeded after transition to the Direct Loan Program.
- 85% of respondents indicated that they needed fewer or the same number of staff to support their participation in the federal loan program than required before their transition to the Direct Loan Program.
- 83% of respondents felt that their students receive better or equal service in the Direct Loan Program.
- If given the choice, fewer than 15% of respondents would consider returning to the bank-based system of providing federal loans.

**About the Higher Education Loan Coalition (HELC)**

HELC is a grassroots organization of practicing financial aid administrators dedicated to the continuous improvement and strengthening of student loan programs. Since its inception in the early 1990s and through its transformation to the Higher Education Loan Coalition, the National Direct Student Loan Coalition has been seen as the leading voice in student lending reform and student advocacy. The founding members recognized the need for an organization to work with the Department, Congress and the community to develop a strong and effective Federal Direct Loan Program.

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