Difference between Federal and Private Student Loans

Center Forward Basics

October 2021

Overview

Millions of students take out federal and private student loans every year to attend college and graduate school. 56% of bachelor's degree recipients from public and private non-profit four-year colleges and universities graduated with at least some student debt. As students begin thinking about their various options for paying for college, they will likely consider both federal and private loans. This Basic will explain and explore both Federal and Private Student Loans and the major differences between the two.

Federal Student Loans

Federal student loans comprise the overwhelming majority of student loans. They are originated and funded by the federal government, and serviced by companies contracted by the government. In order to receive federal student aid, students must complete the Free Application for Federal Student Aid (FAFSA). In addition to federal student loans, the FAFSA also determines eligibility for other federal student aid like grants and work-study. Federal student loans are either:

1. **Direct Subsidized Loans**
    a. These loans are available to undergraduate students with demonstrated financial need. Recipients are not responsible for paying the interest charged on the loan while in school. Taxpayers assume responsibility for the interest accrued in that time period, which is why they are called "subsidized" loans.
    b. Interest rates are fixed and generally lower than the rate on Direct Parent PLUS loans or private education loans.

2. **Direct Unsubsidized Loans**
    a. These loans are available to undergraduate and graduate students. Students are not required to demonstrate financial need to qualify for this type of student loans, and no credit history is required to qualify.
    b. Interest begins accruing at the time of the loan disbursement.

3. **Direct PLUS Loans:**
    a. These loans are made to parents (Direct Parent PLUS) and eligible graduate and professional students (Direct Grad PLUS). Interest rates are fixed on PLUS loans. In order to qualify, the borrower must have no recent credit problems. The PLUS loan program allows graduate students and parents of undergraduate students to borrow up to the cost of attendance with no annual or aggregate limits. A borrower's ability to repay is not considered when loans are made.
    b. PLUS loans have higher interest rates and origination fees than other Federal Student Loans.

Center Forward Basics

Center Forward brings together members of Congress, not-for profits, academic experts, trade associations, corporations and unions to find common ground. Our mission: to give centrist allies the information they need to craft common sense solutions, and provide those allies the support they need to turn those ideas into results.

In order to meet our challenges we need to put aside the partisan bickering that has gridlocked Washington and come together to find common sense solutions.

For more information, please visit www.center-forward.org

Key Terms and Facts

- **Scholarship** - a type of free money, which can be based on need, academic merit, talent, or a particular area of study.
- **Grant** - a form of financial aid that doesn't have to be repaid.
- **Loan** - borrowing money to attend a college or career school that must be repaid.
- Approximately **42.9 million** Americans with student loan debt each owe an average **$28,800** for their loans.
- Federal student loans make up **92.11%** ($1.591 trillion) of outstanding student loans. Private loans make up the remaining **7.89%** (136.31 billion).
- Average Cost of College 2020-2021 (Tuition & Fees):
    - Private: $37,650
    - Public (out of state): $27,020
    - Public (in state): $10,560

Private Student Loans

Private student loans are made by lenders such as banks, credit unions, state agencies, or schools. Students can use their loans to pay for a variety of education expenses such as tuition, room and board, fees, books, supplies, transportation, and computers for school, though bank lenders routinely certify loan amounts with schools to guard against unnecessary borrowing. Students usually take out private student loans with a cosigner such as a parent or a guardian. During the loan application process, banks and financial institutions take into account the students and co-signer's financial information and credit profile, which allows a student to benefit from their co-signer's better credit profile. Private student loans do not have the same limits as federal undergraduate loans.

Private student loans offer borrowers a choice of variable or fixed interest rates. Fixed rates are the same monthly loan payments, while variable rates may go up or down due to an increase or decrease to the loan's index. For repayment plans, students are also able to make interest-only or fixed payments while they are attending school to keep overall loan costs low. Private student loan repayment terms vary by lender. Some lenders offer only one 10-year repayment term, which mirrors the standard term for federal loans. Others have terms ranging from five to 15 years. Additionally, once a student graduates, they will generally have a grace period of six months before they begin to make principal and interest payments. While these loans typically go into default if one misses three monthly payments, files for bankruptcy or defaults on another loan, the overall private student loan default is less than 2% annually.

Key Differences

There are key differences between federal and private loans. For example, federal student loans are not underwritten and do not assess the ability to repay. Also, many federal student loans offer income-based repayment plans, which base monthly payment amounts on the borrower's salary after college. Additionally, federal student loans allow the borrower to change their repayment plan even after they've taken out the loan. If one does not make the scheduled student loan payments for at least 270 days (nine months), it is considered to be in default, though the government continues to collect on the loans by garnishing wages or even Social Security payments.

Additionally, undergraduate federal loans to students are limited to $12,500 annually and $57,500 total. Graduate students can borrow up to $20,500 annually and $138,500 total in federal Direct Loans to graduates. Federal PLUS loans to parents of undergraduates and to graduate students are limited only by what a school determines to be the total cost of attendance, minus other aid. Because private student loans are not subsidized by the government, they are regulated differently from federal loans which are funded by the federal government. Federal loans are governed by the Higher Education Act and regulated by the Department of Education. Private student loans are regulated, depending on the type of lender, by state banking regulators, the Federal Deposit Insurance Corporation (FDIC), the Office of the Comptroller of the Currency (OCC), and the Consumer Financial Protection Bureau (CFPB). Private student loans are also governed by state and federal statutes, including, among others, the Truth in Lending Act (TILA), the Equal Credit Opportunity Act (ECOA), the Fair Credit Reporting Act (FCRA) and the Dodd-Frank Wall Street Reform and Consumer Protection Act.

Conclusion

As people work to pay back their loans, many employers offer student loan benefit options for their employees such as fixed contributions, matching contributions, 401 (k) matching, consolidation and refinancing. These employer-based student loan relief programs are becoming an increasingly popular employee benefit. Overall, many students seek scholarships and grants to help ease the financial burden of paying for higher education. Many will also decide to take a loan to help pay for college tuition. Nearly one-third of all American students go into debt to pay for higher education, and the average student loan debt reached a high of $28,800 in 2020.

Links to Other Resources

- College Board — Trends in College Pricing and Student Aid 2020
- Federal Student Aid — When it comes to paying for college, career school or graduate school
- Federal Student Aid — Federal student loans for college or career school are an investment in your future
- Investopedia — Student Loan Debt: 2021 Statistics and Outlook
- Measure One — Private Student Loan Report
- Morgan Stanley — Student Loans and the CARES Act: What to Know
- New York Times — A Federal College Loan Program Can Trap Parents in Debt
- Sallie Mae — Compare Federal vs Private Loans
- U.S. News — See 10 Years of Average Total Student Loan Debt