Impact of the Lending Crisis on Student Loans

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Problem Identification

Similar to the housing crisis, the student lending industry has also become another victim of the recent subprime credit crisis. The lending industry has recently imposed new constraints upon federal and private student loans. Changes are not only embodied in the lending policies, but also new criteria for granting student loans are established.

Lenders that process Federal Stafford Loans and PLUS Loans, as well as private loans providers, require students who plan to borrow for the first time effective Spring 2008 semester to have higher credit scores. In addition, student borrowers should anticipate higher interest rates as the student loan industry tries to cope with the credit crisis and the consequential effects of the College Cost Reduction and Access Act of 2007, which has cut payments to lenders and guarantee agencies.

According to Mark Kantrowitz, the publisher of FinAid.org which is an online provider of student aid information, he predicts that many student loan companies will no longer issue loans to students with credit scores below 650, and moreover the industry will require student loan applicants to have co-signers.

Sallie Mae (SLM), the nation's largest student loan lender, has stated in its recent Securities and Exchange Commission filing that it would no longer offer loans to students with higher credit risks (the subprime borrowers). Sallie Mae has noticed higher than expected default rates. The loan company has also withdrawn from a recourse loan program in which it had shared risk with for-profit education companies for loans to students with poor credit.

According to FinAid.org (a website guide to student financial aid), changes in federal policy may affect Stafford and PLUS borrowers. Students should expect lenders to cut loan discounts and increase the minimum balance requirements for loan consolidation. Moreover, FinAid.org expects that federal policy will discourage loan consolidation and that minimum balances for loan consolidation will be $10,000. In addition, FinAid.org expects that loan discounts like origination fee waivers and consolidation discounts will probably be cut.

Objectives, Scope and content of Study

This paper, which draws its framework from published works, is undertaken to fulfill the following five objectives:

1. To highlight the impact of the subprime lending crisis on the student lending industry and its recent changing lending policies. Student lenders are being very careful as to whom they are lending, and they want to make sure they will be able to get those loans paid back.
2. To highlight the consequential effects of the new lending policies on students who depend on costly loans to pursue their undergraduate and graduate education.
3. To highlight the concerns of financial aid professionals about the current student loan market and the potential increasing costs for students, in addition to increasing college tuitions and accommodation.
4. To highlight students' views and perceptions of the burdens and financial obligations of changes in student loan industry and the growing costs of higher education.
5. To provide a list of recommendations.

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