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IN FOCUS

November 1, 2024

Federal Student Loan Program Models

The federal government has played a central role in facilitating the making of loans to finance students' postsecondary education since at least 1958. The program models used to provide federal student loans have since changed considerably.

The Higher Education Act (HEA; P.L. 89-329, as amended) authorizes the primary federal student loan program—the William D. Ford Federal Direct Loan (Direct Loan) program—which uses a *direct loan* model. Other federal student loan programs authorized under the HEA include the Federal Family Education Loan (FFEL) program, which uses a *loan guarantee* model, and the Perkins Loan program, which uses an *institutional revolving loan fund* model. This In Focus describes each of these models and selected pros and cons of each.

Outstanding HEA federal student loan debt totals about $1.6 trillion borrowed by or on behalf of about 42 million individuals. This debt represents loans made under all three of the loan models.

Direct Loan Model

Per the Federal Credit Reform Act (FCRA; P.L. 101-508), a direct loan is "a disbursement of funds by the Government to a non-Federal borrower under a contract that requires the repayment of such funds with or without interest." Under this model, the federal government acts a lender, making loans using federal funds. Once made, the federal government owns the loans.

The federal government is also responsible for program administration. In the case of the Direct Loan program, the U.S. Department of Education (ED) is responsible for overall program administration, and HEA Section 456 requires ED "to the extent practicable" to award contracts for many of the program's administrative functions, such as loan servicing. Thus, many of the day-to-day functions of the program (e.g., processing monthly loan payments) are fulfilled by federal contractors rather than federal employees.

Most federal student loans made and outstanding today are Direct Loan program loans, totaling about $1.4 trillion in outstanding loan debt.

Loan Guarantee Model

FCRA defines a loan guarantee as "any guarantee, insurance, or other pledge with respect to the payment of all or part of the principal or interest on any debt obligation of a non-Federal borrower to a non-Federal lender." Under a loan guarantee model, private sector or state lenders make loans to borrowers with nonfederal funds, and the federal government guarantees those loans against loss due to specified reasons such as borrower default or death. If one of these events occurs, the federal government reimburses lenders for some or all of the borrower's loan balance.

While the federal government is responsible for the overall administration of a loan guarantee program (e.g., program oversight, establishment of broad program policies), lenders typically are responsible for administering the day-to-day aspects of the program, such as loan servicing.

In the FFEL program, other entities known as guaranty agencies (GAs) also play a role in program administration. GAs are state and nonprofit entities that receive federal funds to play a role in administering aspects of the federal loan guarantee, including taking possession of defaulted loans to initiate collection work and reimbursing lenders (using federal funds) when loans default. Along with the loan guarantee, FFEL lenders receive other types of federal payments as an incentive to participate in the program. For instance, they receive special allowance payments if the HEA-specified interest rates on their FFEL program loans are lower than the market-indexed lender rate.

The FFEL program (and its predecessors) was the primary federal student loan program prior to the Direct Loan program. (From 1994 to 2010, the Direct Loan program and FFEL program operated side-by-side. During this time, institutions of higher education [IHEs] could participate in the program of their choice.) Title II of the Health Care and Education Reconciliation Act of 2010 (P.L. 111-152) terminated the authority to make new FFEL program loans effective July 1, 2010.

While loans are no longer being made through the FFEL program, FFEL program loans totaling $169.0 billion remain outstanding; borrowers remain responsible for repaying those loans, and some administrative functions continue.

Institutional Revolving Loan Fund Model

FCRA does not address institutional revolving loan funds. Typically, under this model IHEs make loans using institutionally established revolving loan funds, which are financed with a combination of federal and institutional money. Borrowers repay their loans, plus interest, to the IHE, and the IHEs use those repayments to extend new loans to new borrowers.

Although the federal government is responsible for overall program administration (e.g., program oversight, establishment of program policies), IHEs typically are responsible for administering day-to-day aspects of the program, including loan servicing.

Before it began relying more heavily on loan guarantees in the 1960s, the federal government used the institutional revolving loan fund model as a key part of its lending efforts. The Perkins Loan program (and its predecessor, the National Defense Student Loan program) used the institutional revolving loan fund model. The Federal Perkins Loan Program Extension Act of 2015 (P.L. 114-105) terminated the authority to make new Perkins Loans effective October 1, 2017. While loans are no longer being made under the program, Perkins Loans totaling about $3.3 billion remain outstanding; borrowers remain responsible for repaying those loans, and some administrative functions continue.

Table 1 summarizes selected features of each student loan program model.

Table 1. Selected Features of Student Loan Program Models

Program Model (example HEA program)	Source of Loan Capital	Party Responsible for Day-to-Day Administration
Direct lending (Direct Loan)	Federal government	Federal government
Loan guarantee (FFEL)	Private lenders	Private lenders
Institutional revolving loan fund (Perkins Loan)	Combination of institutional and federal funds	IHEs

Source: CRS analysis.

Selected Pros and Cons of Loan Program Models

The student loan program models discussed in this In Focus each have pros and cons that Congress might weigh in considering whether the current federal student loan system meets intended objectives or might be changed if it does not. Two key aspects of program design for each of these models are (1) loan capital source and (2) program administration.

Loan Capital Source

Under a direct loan model, the federal government disburses funds directly to borrowers, resulting in an initial outlay of federal funds, albeit with an expectation that those funds will be repaid with interest. Under a loan guarantee program, by contrast, private lenders make loans to borrowers using their own capital. Even though private funds are used to make loans in a loan guarantee program, the loans still carry a budgetary cost for the federal government due to accounting rules established under FCRA. These rules enable an apples-to-apples comparison between direct loans and loan guarantees, defining the cost of both as the net present value of future federal cash flows. Thus, use of a loan guarantee model may not necessarily result in a lower cost to the federal government.

An institutional revolving loan fund model typically requires IHEs to make loans using a combination of federal and institutional funds. Outlays of federal funds comprise the federal share of funds used to capitalize an institutional revolving loan fund.

In the Perkins Loan program, Congress provided the federal share of revolving loan funds allotted to IHEs by enacting definite budget authority in appropriations acts. The FFEL and Direct Loan programs are supported by indefinite budget authority in the HEA. In the former context, Congress controlled federal outlays by setting the dollar amount of federal contributions, while in the latter, program outlays are determined by (for example) the HEA's delineation of loan terms and conditions. Definite budget authority could be viewed as providing more direct congressional control over outlays, but a loan model funded on that basis might curtail the number or amount of student loans available, in the event that definite budget authority cannot accommodate all prospective borrowers.

A requirement that IHEs use some of their own funds to make loans, as is typical of the institutional revolving loan fund model, essentially requires them to have some skin in the game; if a borrower were to default or otherwise not repay their loan, the IHE would suffer a financial loss (as would the federal government as contributor of a portion of loan capital). However, some IHEs may not have sufficient funds to capitalize a revolving loan fund.

Program Administration

A loan guarantee model could permit multiple lenders to participate in the federal student loan marketplace, which could possibly infuse market competition to help realize program efficiencies and lead to better customer service for borrowers. However, as was the case with the FFEL program, which involved a large number of lenders, complexities for the federal government in overseeing so many entities may arise. Numerous lenders may also result in complexities in navigating the program for other parties that interact with lenders, such as IHEs and students.

A direct loan model may give the federal government a greater level of direct oversight of program administration, as it could potentially administer all aspects of the program, or in the case of the Direct Loan program, directly contract with loan servicers. This may also result in a more streamlined and uniform borrower experience. However, ED has experienced challenges in administering the Direct Loan program over the years.

Regarding the institutional revolving loan fund model, in the Perkins Loan program IHEs were allowed a level of control over program administration typically not seen in the other models in exchange for their financial contributions to the revolving loan fund. For instance, within federally specified parameters, IHEs had some flexibility in determining which students they would offer Perkins Loans. This might enable IHEs to better target federal student aid to certain student populations. However, this institutional flexibility would necessarily mean the federal government would have less say in identifying eligible borrowers.

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