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Protecting Graduate Borrowers in the Private Market

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For the past 20 years, graduate student borrowers have largely avoided financing gaps through the Graduate PLUS (Grad PLUS) loan program. However, recent higher education legislation has both eliminated Grad PLUS and instituted new federal lending caps for graduate students. Although many programs' costs fall well within the caps—and some institutions are revisiting their financial aid packages—students, particularly in high-cost, high-ROI fields, may find themselves seeking additional financing through the private student loan market. This presents an important opportunity to learn from past challenges with private student loans, examine which consumer protections exist and who will enforce them, and ensure that borrowers who choose to use private loans do not face undue risk.

The Problem

Private student loan lenders have a predatory history of aligning their incentives with institutions', often at the expense of borrowers' best interests.

Before Grad PLUS, students often financed costs above federal loan limits through private loans. Because the overall market share of private student loans grew by more than 900% in inflation-adjusted terms from 1995 to 2006, policymakers had real concerns about students overleveraging their borrowing power and about lenders' lenient standards. The lending environment was made even worse for borrowers by questionable relationships between financial aid officers at colleges and universities and private lenders in a largely unregulated marketplace.

A 2007 New York State investigation examined anti-competitive and deceptive practices by private student loan providers, uncovering a range of unsavory relationships between lenders and institutions. Many schools steered borrowers to lenders that offered worse terms in exchange for profit-sharing, and some financial aid administrators even received personal kickbacks for funneling students to lenders, padding their own wallets in the process. These flagrant quid-pro-quo arrangements led to stricter restrictions on the private market and on how colleges and universities engage with lenders. Yet these important regulations—and conversations about private student loan protections—largely fell by the wayside after the creation of Grad PLUS, which reduced private lenders' market share to less than 10% of student loans by keeping most graduate student borrowers in the federal loan program.

Vulnerabilities in the government's enforcement capabilities leave students at risk from preventable predatory behavior.

The 2007 New York investigation and subsequent 2008 financial crisis led to multiple actions related to private student loans, including the creation of Preferred Lender List (PLL) regulations. PLLs were a key element of federal reform after the risks of private student lending were exposed in the New York investigation, and colleges and universities use the lists to identify lenders that meet their institutional standards for private loan financing. Today, PLL regulations impose strict guardrails on revenue-sharing agreements, conflicts of interest, and other conduct issues, helping protect students from misleading or financially motivated loan recommendations and encouraging transparency for borrowers.

While the Department of Education (Department) regulates institutional compliance with PLL regulations, the Consumer Financial Protection Bureau (CFPB) has maintained oversight and regulatory authority over myriad private financial products, including private student loans, since its creation in 2010 under the *Dodd-Frank Act* that followed the Great Recession. The CFPB also houses a legally mandated student loan ombudsperson who investigates complaints and issues related to private student loans. But the Trump Administration's Department of Government Efficiency (DOGE) hollowed out the agency by cutting nearly 90% of its staff. The student loan ombudsperson position was ultimately reinstated, but questions remain about the agency's ability and interest in effectively regulating private student loans.

Before the CFPB's creation, Congress passed a series of laws related to private student lending that were ultimately rolled into the 2008 reauthorization of the *Higher Education Act*, including the PLL regulations that exist today. Yet they largely haven't been stress-tested, given the decrease in private loan volume since then and other shifts in the regulatory and student loan environments that have made them look markedly different from when they were created, including staffing cuts at both the CFPB and the FSA. Taken together, these shifts expose an imminent need to understand not only how these laws apply 18 years after their passage, but also which body will enforce them.

Cross-jurisdictional oversight complicates congressional action on private student lending.

Private student loans exist outside Title IV of the *Higher Education Act*, which governs the federal Direct Loan program. In practice, oversight responsibility falls to the House Committee on Financial Services and the Senate Banking Committee. But given the educational nature of private student loans, any legislative action typically involves the corresponding committees: Education and the Workforce in the House, and Health, Education, Labor, and Pensions (HELP) in the Senate. Cross-jurisdictional regulation is difficult under the best of circumstances—and the dynamics of today's Congress, combined with the politics of private loans, only add fuel to the fire.

Republicans have long been loath to increase regulation on private financial products, including student loans, and the reconciliation process that ended Grad PLUS makes clear their preference that students use the private market to finance funding gaps. On the other side of the aisle, the mere mention of private student loans makes most Democrats uncomfortable. Historically, Democrats have focused on bolstering consumer protections and, at one point in the late 2000s, even voted to eliminate the private-sector loan program altogether. Reaching a productive compromise would require Democrats to be open to recognizing these products as legitimate options and Republicans to be open to discussing consumer protections.

The Solution

A long-term solution will need to examine how to situate private lending within the larger financing landscape and modernize a regulatory approach to meet new student loan realities. In the short term, Congress must focus on two pressing priorities: ensuring compliance with PLL regulations and determining the enforcement mechanisms for consumer protections.

Ensuring preferred lender lists benefit students.

The Department and FSA should prioritize a proactive and intentional oversight strategy of institutions as they develop and update preferred lender lists, ensuring not only that these relationships between lenders and institutions comply with federal law, but also that transparency is maintained for students and borrowers. Student loan program changes of this magnitude open the door to predatory behavior and bad actors across the marketplace that might seek to exploit loopholes amid reduced enforcement capabilities.

In the long term, Congress should revisit whether PLL regulations meet the needs of the present market. Increased competition in private lending stands to potentially benefit students—yet they may not recognize that they are not obligated to use a specific lender on their institution's PLL, nor understand how to compare options. There is also a need for increased transparency in how institutions select lenders for their PLLs, including the criteria they use to evaluate lenders, the arrangements between lenders and institutions, and ways for students to verify this information independently. The primary goal should be to ensure fair costs and terms for borrowers, not higher approval rates or preference from the institution's financial aid staff. Yet as it stands today, there's no way to confirm if institutions are selecting lenders that work in the best interests of their students.

Enforcement of private lending regulations.

Colleges and universities are under intense financial pressure that has historically been addressed by increasing graduate enrollment. This presents a unique risk for borrowers, highlighting the need for a two-pronged strategy of harm reduction and effective oversight. While questions remain about the CFPB's ability to provide effective oversight, private student loan borrowers are not without recourse at the federal level. The Federal Trade Commission (FTC) regulates what is known as the Holder Rule to protect borrowers when a product they finance is defective or never delivered. Specific criteria must be met for this rule to apply to private student loans, in which case borrowers can bring claims against their institutions if the school engages in fraud or misrepresentation. This ensures that lenders share some responsibility for that misconduct. Borrowers must file a complaint with the FTC to initiate this process.

State attorneys general will also be important enforcers as localized, on-the-ground watchdogs. Several states—including Connecticut, Illinois, California, Michigan, Oklahoma, and Washington—have a "borrower's bill of rights," ensuring consumer protections for private student loan borrowers within the state. State attorneys general can also enforce Unfair, Deceptive, or Abusive Acts or Practices (UDAAP) laws, which were created under the *Dodd-Frank Act*. Recent legal analyses note that while the *Consumer Financial Protection Act* explicitly grants state attorneys general the authority to bring civil actions to enforce UDAAP, limitations prevent states from serving as an in-kind substitute for CFPB enforcement.

Regulators should additionally be on the lookout for new financial products that peg themselves as "gap-fillers" but may be predatory, with high interest rates and unfavorable terms. State attorneys general should consider all possible enforcement pathways, including mechanisms to receive borrower complaints, resources to provide to colleges and universities to ensure compliance with PLLs, and legal strategies to ensure that lenders and institutions hold up their end of the bargain.

Critiques and Responses

History has already shown that private student loans are bad for borrowers. What makes this time different?

There are now important regulations that can protect students from the predatory private lending practices that went largely unchecked during the heyday of subprime lending 20 years ago. With the Grad PLUS program ending and new loan limits taking effect, graduate students enrolling in high-cost, high-ROI programs may have few options other than the private market to finance any funding gaps.

Yet this time is also different because we know so much more. The 2000s showed us how misaligned incentives can cause significant financial harm to student borrowers. We now have better tools in the federal regulatory framework to ensure that colleges and universities work with lenders that offer options tailored to students' unique circumstances, rather than simply getting them through the door regardless of the cost or risk.

Without a fully functional CFPB, private student loans should not be allowed.

Other actors and avenues exist to protect borrowers who seek private loans. Laws already on the books at both the federal and state levels require lenders and institutions to develop private lending programs that protect students, while state attorneys general and other regulators have the authority to enforce consumer protections. These safeguards are not a substitute for a fully functional CFPB, but they can make private lending significantly safer in the meantime. Rather than chase a false promise that private student loans will simply disappear, we should strengthen protections that help borrowers today.

Even if private lending is a safe option for students, there's no guarantee that students facing a financing gap will qualify.

The best use case for private loans may be for programs like law, medicine, and dentistry that have higher upfront costs but also substantially higher long-term ROI for graduates. Borrowers pursuing these types of graduate programs may qualify and choose to use a private loan to finance any funding gaps, as private lenders will trust that they will have a high likelihood of successful repayment. For the borrowers who go that route, consumer protections must align with the realities of borrowing a private student loan.

Given the nature of private financial products and the regulations governing loan underwriting, some students may not qualify for a private loan, or the available options may not be favorable to them. In the long term, it's important to consider how to rethink private student loans, including outcomes-based financing products, so that they can work for students across all financial circumstances.

If we further regulate private lenders, we will push them out of the market, leaving even fewer options for students to finance their graduate education.

As Congress considers how to regulate private student loans effectively, it must strike the right balance between recognizing the private market's new and larger role in graduate student lending and safeguarding reliable access to financing options for students of all backgrounds to pay for graduate school. While Congress decided to curb the federal role in lending for graduate programs, it must not trade away the federal responsibility to protect borrowers from predatory behavior and financial harm that can result from an insufficiently regulated private loan market.

Conclusion

Private loans have largely flown under the radar in broader conversations about financing higher education over the past two decades. Yet like it or not, more graduate students will lean on the private market in a post-Grad PLUS world. There needs to be increased scrutiny of these financial products and of the partnerships institutions form with lenders to ensure transparency and accountability. If approached strategically, there's an opportunity for private loans to help preserve access to graduate programs while ensuring that effective harm-reduction measures are in place for student borrowers.