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IN FOCUS

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History of Federal Student Loan Origination Fees

A loan origination fee is a one-time, upfront fee charged by a lender to cover costs associated with making a loan. Under the Higher Education Act (HEA), the Secretary of Education (the Secretary) charges origination fees to borrowers of certain loans made under the William D. Ford Federal Direct Loan (Direct Loan) program. This In Focus provides an overview of Direct Loan origination fees and their legislative history.

Direct Loan Origination Fees

Under HEA Section 455(c), the Secretary charges borrowers of Direct Subsidized, Unsubsidized, and PLUS Loans an origination fee. The Secretary does not charge an origination fee on Direct Consolidation Loans. These fees help offset Direct Loan subsidy costs by passing along some of the costs to borrowers. The Secretary calculates origination fees as a percentage of the loan principal borrowed and deducts the fee proportionally from the proceeds of each loan disbursement to a borrower.

Currently, the HEA specifies a 1% origination fee for Direct Subsidized and Unsubsidized Loans and a 4% origination fee on PLUS Loans. During periods when a budget sequestration order applies, origination fees are to be increased by the uniform percentage in the sequestration order. Thus, since 2013 Direct Loan origination fees have been higher than what is prescribed in the HEA. For example, Direct Subsidized and Unsubsidized Loans made on or after October 1, 2020, have had an effective origination fee of 1.057%, and PLUS Loans made on or after that date have had an effective origination fee of 4.228%.

Because the Secretary deducts origination fees from the proceeds of a loan, a borrower receives less than the full amount they borrow to apply toward their cost of attendance (COA) at an institution of higher education. However, borrowers remain responsible for repaying the full amount of principal borrowed, plus interest that accrues on that amount. Some have described this dynamic as interest accruing on origination fees. For example, if an individual borrowed $3,500 in Subsidized Loans with an origination fee of 1.057%, the Secretary would deduct an origination fee of $36.99 from the amount borrowed ($3,500 x 0.01057) and disburse the remaining $3,463.01 to the borrower to apply toward their COA The borrower would be responsible for repaying the full $3,500, plus interest that accrues on that amount.

In FY2024, the Secretary disbursed about $148.5 billion in Direct Loans (including Consolidation Loans) to borrowers, and retained approximately $1.7 billion in origination fees.

Origination Fee Legislative History

Origination fees were first authorized under the Guaranteed Student Loan (GSL) program in 1981. (The GSL program was subsequently renamed the Federal Family Education Loan [FFEL] program and was a predecessor to the Direct Loan program. In this In Focus, the GSL program will generally be referred to as the FFEL program.) The fees were intended to help offset the cost of FFEL program loan subsidies, including interest subsidies. Later, the Higher Education Amendments of 1992 (P.L. 102-325) authorized a Direct Loan demonstration program. Although earlier bill iterations would have excluded origination fees as a feature of loans made under the new demonstration program, Congress ultimately retained the fees as a Direct Loan feature. In 1993, Congress permanently authorized the Direct Loan program, retaining loan origination fees in the program. Loan origination fees in both the FFEL and Direct Loan programs were subsequently updated multiple times. Legislative materials indicate that throughout the history of origination fees in the programs, Congress and stakeholders often weighed multiple considerations that included whether imposing origination fees might deny students financial resources to put toward their postsecondary educational expenses and whether the loan programs could remain viable without such fees.

Initial Establishment of Origination Fees

The GSL (FFEL) program was first authorized as part of the original HEA in 1965. Under the program, private and state-based lenders made loans to borrowers using private capital, and the federal government guaranteed those loans against loss in limited circumstances (e.g., borrower death or default). Lenders owned the loans and were responsible for performing loan servicing functions. State and nonprofit guaranty agencies received federal funds to play the lead role in administering many aspects of the program related to the loan guarantee, including reimbursing lenders when loans were placed in default. The HEA specified interest rates on program loans that, at times, were lower than market rates and, depending on the loan type, provided for other borrower benefits such as loan interest payments made by ED on behalf of borrowers during periods of deferment. The federal government subsidized these and other benefits by making payments to lenders to compensate them for financial costs associated with the benefit.

From 1965 to 1981, loans made under the program did not have origination fees. The Omnibus Budget Reconciliation Act of 1985 (P.L. 97-35) first authorized lenders to charge an origination fee to borrowers of up to 5% of loan principal on a single type of FFEL program loan, which was then referred to as a *guaranteed student loan* and was a predecessor to the Stafford Loan. If a lender charged a borrower the origination fee, then the lender paid the origination fees to the federal government. If a lender charged the borrower an origination fee in an amount of less than 5% of loan principal, the lender paid the government the difference between 5% of the loan principal and the amount collected from the borrower. These origination fees were intended to help offset the cost of interest subsidies available on the guaranteed student loans and other FFEL program administrative costs.

A 1981 report from the Senate Committee on the Budget (S.Rept. 97-139) leading up to the establishment of origination fees stated that the committee was concerned that instituting an origination fee would "require greater financial effort on the part of students and their families to contribute to the operation" of the program. However, the committee determined that elimination of the federal government interest subsidies "would result in a precipitous and progressive drop in lender participation, and would ensure unreasonable burdens of debt, above that imposed by the 5 percent origination fee." Thus, an origination fee was authorized to help "maintain a viable system of student loans through the private capital market."

Subsequently, the Higher Education Amendments of 1992 (P.L. 102-325) authorized origination fees on other types of FFEL program loans: an origination fee of 5% for PLUS Loans to parents of dependent undergraduate students and for Supplemental Loans for Students (SLS) and a "6.5% combined origination fee and insurance premium" on Unsubsidized Stafford Loans. Although legislative materials do not appear to provide an explicit rationale for extending origination fees to PLUS Loans and SLS, P.L. 102-325 states that the combined origination fee and insurance premium on Unsubsidized Stafford Loans was to be used by the Secretary "to pay the Federal costs of default claims paid for loans ... and to reduce" other loan costs.

Origination Fees in the Direct Loan Program

The Higher Education Amendments of 1992 also authorized a Direct Loan demonstration program to test the viability of a federal student loan program under which the federal government would use federal funds to make loans directly to students. Previous iterations of the bill that would become P.L. 102-325 phased out origination fees in the FFEL program and excluded origination fees as a feature of loans made under the Direct Loan demonstration program. Ultimately, the act retained origination fees in the FFEL program and specified that Direct Loans were to have the same terms and conditions as loans made under the FFEL program.

The Omnibus Budget Reconciliation Act of 1993 (P.L. 103-66) made permanent the Direct Loan program and required the Secretary to charge borrowers a 4% origination fee on Direct Loan program loans. The act also (1) repealed the 6.5% combined origination fee and insurance premium on Unsubsidized Stafford Loans; (2) required lenders to charge borrowers of Unsubsidized Stafford Loans and PLUS Loans a 3% origination fee; and (3) authorized lenders to charge borrowers of Subsidized Loans Stafford Loans a 3% origination fee. (The act also repealed the authority to make new SLS loans.) Additionally, FFEL program borrowers were to be charged a 1% insurance premium. This fee, combined with a 3% origination fee, totaled 4% of loan principal, on par with the loan origination fees charged on Direct Loans. As before, if a FFEL program lender charged a Subsidized Stafford loan borrower an origination fee of less than 3% of loan principal, the lender paid the government the difference between 3% of the loan principal and the amount collected from the borrower. Congressional hearings prior to the law's enactment reveal that, similar to deliberations prior to the establishment of origination fees on GSLs in 1981, stakeholders weighed tradeoffs between eliminating origination fees and the continued availability of other student loan benefits that might not have been available in the private market, such as lower interest rates.

The Higher Education Amendments of 1998

P.L. 105-244, the Higher Education Amendments of 1998, retained the required 3% loan origination fee on FFEL program PLUS Loans and authorized (but did not require) lenders to charge borrowers of both Subsidized and Unsubsidized Stafford Loans a 3% origination fee. It required lenders to charge the same origination fee on both Subsidized and Unsubsidized Stafford Loans but also authorized lenders to charge borrowers of such loans a lower origination fee if they demonstrated "greater financial need" as determined by their family's adjusted gross income. The legislative record does not appear to provide an explicit rationale for authorizing lower origination fees to borrowers with greater financial need.

In light of the 1998 amendments and HEA Section 455(a), which specified that Direct Loans were to have the "same terms, conditions, and benefits" as FFEL program loans, the Administration reduced Direct Subsidized and Unsubsidized Loan origination fees to 3% of loan principal. The Administration asserted that the reduction would aid in lowering borrowers' student loan costs and "could save students hundreds of dollars."

The Higher Education Reconciliation Act of 2005

Origination fees in the Direct Loan program were last amended by the Deficit Reduction Act of 2005 (P.L. 109-171). The act reduced origination fees for Direct Loans on a tiered schedule. It specified that origination fees eventually were to equal 1% of loan principal for Direct Subsidized and Unsubsidized Loans made on or after July 1, 2010, and retained origination fees of 4% on PLUS Loans. (Similar, but not identical, amendments were made to the FFEL program. Authority to make new FFEL program loans was terminated effective July 1, 2010.)

Congressional proponents of the measure stated that the reduced origination fees would "increase the amount of money a borrower actually receives to help pay for his education" but that borrowers would still be required to pay a "small fee ... for the benefit of a consumer loan with a fiscally responsible 8.25 [interest rate] that includes a number of benefits that will assist students as they work to complete their education, allow borrowers to pay back their loans in a timely fashion and assist struggling borrowers to develop repayment options."

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