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Fewer US financial institutions are willing to offer student loans

Article

The news: **Discover Financial Services** is considering offloading its student loan portfolio to a third-party provider.

- It plans to stop accepting applications for student loans starting in February 2024

The trend: Discover isn't the only financial institution (FI) to exit this market.

- **Wells Fargo** sold its student loan portfolio in 2020, and stopped taking applications in 2021.
- **US Bank**, **Bank of America**, and **JPMorgan Chase** all exited the student loan business more than 10 years ago.

Even three major student loan servicers—**The Pennsylvania Higher Education Assistance Agency (PHEAA)**, **Granite State Management and Resources,** and **Navient**—have left the market after servicing around 16 million student loans.

- Earlier this year, these service providers transferred their remaining loans to former competitors that maintain contracts with the US Department of Education.

Why the exodus? Many FIs crunched the numbers for staying in the student loan business, and they determined that it wasn't worth it anymore.

- For major banks, student loans represented a small percentage of their business, yet it increased their reporting and regulatory requirements.
- In recent years, the US government stopped backing private student loans, increasing risks for FIs offering these loans.

Discover, on the other hand, left the business even though student loans were a "solid performer" for the company.

- Discover faced regulatory scrutiny and consent orders in 2015 and 2020 due to improper loan servicing practices—including issues with validating payments, canceling payments without notification, and misstating minimum payments.
- It also encountered costly compliance problems, such as overcharging merchants for nearly 16 years and facing penalties in 2020—including a $35 million payment enforced by the Consumer Financial Protection Bureau (CFPB)—after a failed migration to a new student loan servicing platform.

New policy factors at play: Some major policy changes likely made the market even less attractive to lenders.

- Last November, the Biden Administration announced borrowers could walk away from their federal student loans by declaring bankruptcy.

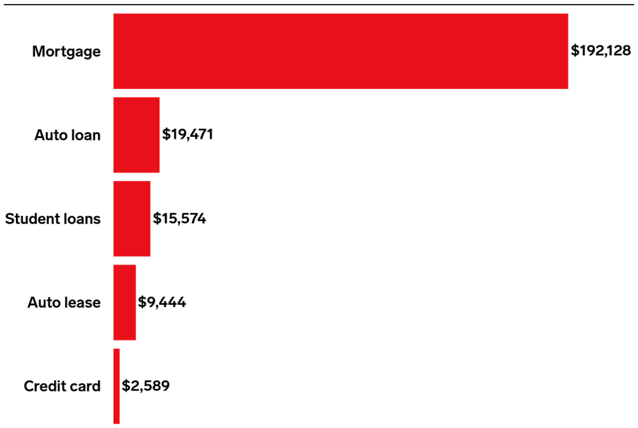
- While it's always been technically possible to discharge federal and private loans through bankruptcy, borrowers used to have to prove "undue hardship" in court, which led to inconsistent treatment.
- After the policy update, the US Department of Education and US Department of Justice released updated bankruptcy guidelines to ensure those wishing to part with federal student loans were treated uniformly.

Key takeaways: In an environment where FIs are actively cutting risk and costs, it makes sense for them to step away from less profitable or more expensive services. A few FIs still remain in the student loan business, but some are actively lobbying to maintain profitability of their business.

- For example, online bank **SoFi** sued the US Department of Education to end the recent pause on student loan repayments.
- That move didn't land well with borrowers, however, which may have motivated SoFi to later announce its support for President Biden's plan to cancel $20,000 in student debt.

The growing number of student debt bankruptcies could also motivate more FIs to leave the refinancing market.

Average Debt Held by US Gen Z Internet Users, May 2022
per person amount



Note: ages 18-25
Source: Credit Karma, "Average American debt by age and generation in 2022," Sep 27, 2022
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