New Legislation Introduced to Forgive Private Student Loans upon Bankruptcy

By Brooke Heath

This week, legislation was introduced by Illinois Senator Dick Durbin (D) that would allow private student loans to be forgiven upon bankruptcy. Currently, neither private nor federal student loans will be discharged for a borrower who files for bankruptcy, with the rare exception of extreme hardship.

Private student loans, also known as alternative loans, offer students an option other than federal student loans, which are backed by the federal government. Private loans are borrowed through private institutions but are not administered by the Federal Family Education Loan (FFEL) Program.

While private loans can be beneficial to students who find that federal loans cannot cover all of the costs involved with obtaining an education, they can also be a financial burden to repay. This is because private loans usually have very high interest rates and fees. According to Higher Education Washington, Inc.'s *NewsLine*, some private loans have been reported to have variable interest rates of 15% or higher. Also, unlike federal student loans, private loans usually have higher loan limits, and there are no public regulations governing the terms and costs associated with private student loans, as there are with federal loans.

"Private student loans are incredible money-makers for loan companies, and students end up saddled with sky-high interest rates and mountains of debt," said Senator Durbin. He continued, "I don't think many 17- or 18-year-old students realize the long-term impact of their loan decisions. Some of these private student loan repayment schedules—with double-digit interest rates—can follow a student borrower from graduation to the grave."

According to a press release on the senator's website, the sector of private student loans is the fastest growing and most profitable in the student loan industry. The press release also said that in 2006, private loans accounted for around 20% of total student loan borrowing, compared to only 5% 10 years ago.

Prior to a change in 2005, the bankruptcy code allowed borrowers to discharge private student loans but not federal student loans. However, the 2005 modification prohibits private student loans from being forgiven upon bankruptcy. This provision protects the private lending industry's investments.

Senator Durbin's legislation would reverse the 2005 change to the bankruptcy law, ensuring that private student loans would again be discharged upon filing for bankruptcy. According to the senator's website, this would place private student loan lenders in the same position as all other private creditors.