

STUDENT LOANS BLOG

Senator Durbin: Private Student Loans Should be Dischargeable in Bankruptcy

Posted by [Shannon Rasberry](#) on Mar 29, 2012

A 2005 law that prevented private student loans from being discharged in bankruptcy courts, thereby stripping a vital consumer protection from proprietary college loans that remains available to all other types of consumer loans, should be overturned, according to Sen. Dick Durbin.

Durbin, a Democrat from Illinois, said at a hearing on Capital Hill last week that there was no reason why private student loans should be treated differently from other consumer debt in bankruptcy. The congressional overhaul of bankruptcy laws in 2005 created a situation in which borrowers are stuck with private student loans for life. Durbin said he wanted to restore law to more equitable pre-2005 standards.

“There is no reason why private student loans should get treated differently from other private debt in bankruptcy,” Durbin said in prepared remarks at a Senate judiciary subcommittee hearing. “And it is especially egregious that these private loans are non-dischargeable in cases where a student was steered into the loan while the student was eligible for safer federal loans.”

Durbin said that although the overall growth in student loan debt, which has [reached \\$1 trillion](#), was troubling, even more pressing was the growth in debt from private student loans.

While federal student loans offer affordable, fixed interest rates and a variety of consumer protections — such as deferment and forbearance in times of economic hardships, as well as manageable repayment options such as Income-Based Repayment and federal loan forgiveness programs — private student loans often have high, variable interest rates, expensive origination fees, and a lack of repayment options. “These private student loans are a far riskier way to pay for an education than federal loans,” Durbin said (“[Private Student Loans Should be Dischargeable in Bankruptcy Courts, Senator Says](#),” The Blog of Legal Times, March 20, 2012).

Private Student Loans Are Treated Like Debt From Child Support, Criminal Fines

According to Deanne Loonin, an attorney for the National Consumer Law Center, bankruptcy laws regarding private student loans were changed in 2005 based on the false premise that borrowers of private loans were more likely to abuse the system. “Current bankruptcy law treats students who face financial distress the same severe way as people who are trying to discharge child support debts, alimony, overdue taxes and criminal fines,” Loonin said in written testimony provided at the hearing. “Yet there is no evidence and has never been any evidence to support this assumption.”

Lending Giant Supports Private Student Loan Bankruptcy Reform, Experts Oppose It

Sallie Mae, the largest private student lender, “supports reform that would allow federal and private student loans to be dischargeable in bankruptcy for those who have made a good-faith effort to repay their student loans over a five-to-seven year period and still experience financial difficulty.” However, several financial experts testified that the real problem is tuition inflation, and not the inability to discharge private student loan debt in bankruptcy (“[Durbin Urges Private Student Loans Be Discharged in Bankruptcy](#),” Bloomberg Businessweek, March 20, 2012).

“If the goal is to relieve the debt burden upon student borrowers who have taken on student debt that did not result in higher productivity and earnings potential, removal of the exemption is a blunt instrument that is unlikely to address the root source of the problem, accomplishing instead a one-time, unjust transfer from innocent lenders who did nothing more than give money to people in the hopes of being repaid someday,” said G. Marcus Cole, who teaches commercial and financial law and regulation at Stanford University near Palo Alto, Calif., in written testimony.

Neal McCluskey, associate director of the Cato Institute’s Center for Educational Freedom, Cole testified that restoring the loan discharge rule would have “a very marginal impact” on the issue of student debt. “If lenders know that borrowers can escape repayment through bankruptcy, they would likely raise interest rates to account for that risk and lend to fewer people, discouraging use of such loans,” McCluskey said. “However, students might be more apt to take such loans — and pay still higher college prices — if they think that they will be able to unload their debt without repaying it.”