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Student Debt Debacles

Students who finance their educations through private lenders often wrongly assume that private and federal loans work the same way. In fact, they do not.

Most federal student loans have rates of 6.8 percent (or less) and offer broad consumer protections that allow people who lose their jobs to make lower, affordable payments or to defer payment until they recover financially.

Private student loans — from banks and other private institutions — typically come with variable interest rates and fewer consumer protections, which means that borrowers who get into trouble have few options other than default. Many borrowers did not learn about the differences between private and federal loans until after they became deeply indebted. And because of confusion about variable rates, they are sometimes shocked to learn what they owe when that first bill arrives.

The problem is serious because private student loans now account for $150 billion of the $1 trillion in total outstanding student loan debt in the country, according to the first annual report from the Consumer Financial Protection Bureau's student loan ombudsman.

The report found that many loan servicers — the companies that collect the payments for the lenders — make it extremely difficult for student borrowers to manage their debts. Borrowers often have difficulty finding out how much they owe or getting information about their payment histories. Some struggling borrowers who need loan modification said that servicers forced them to pay more per month than they could possibly afford, without telling them the payments would not prevent default.

In some cases, those who made late or partial payments were subjected to unauthorized checking account deductions that then led to overdrafts and costly fees. One borrower learned that his loan was put into default when a parent who had co-signed for the loan filed for bankruptcy protection. He reported that he could get no information about how to cure the problem.

Slipshod loan servicing makes private student loans even riskier by increasing the likelihood that people will fall behind in payments. The bureaucratic errors and obstacles mean that conscientious borrowers who took out high-priced loans are not only saddled with crushing debt, they may also have their credit ruined — making it extremely hard to refinance their loans or get future loans to buy a home or start a business.

The federal government needs to open up refinancing and debt relief opportunities for these people, as it did for some mortgage holders. The bureau should also set national standards for loan servicers to require clear disclosure of conditions, advance notice of any changes in the status of the account and prompt resolution of customer requests for information. And borrowers who might be eligible for federal loans should be advised to examine that option before plunging headlong into private debt.