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STUDENT LOANS

The Big Pause You Should Take Before Co-Signing a Student Loan

Your Money

By RON LIEBER AUG. 12, 2016

So someone has asked you to co-sign for a student loan.

Chances are, it's your child or grandchild, or perhaps a niece or nephew. You have unrelenting faith in this teenage freshman, or near certainty that graduate school will lead to a lifetime of gainful employment. And maybe you feel badly that the family has not been able to save enough to pay the bills outright.

Fine. But be very, very careful.

When you co-sign for a loan, you, too, are responsible for it. If the primary borrower can't pay, you have to. If that borrower pays late, your credit could get nicked as well. And the mere existence of the loan on your credit report may keep you from being able to get other kinds of loans, since lenders don't always want to do business with people who already have a lot of debt.

In some cases, the lender will try to collect from a co-signer even if the primary borrower is dead, as a recent collaboration between ProPublica and The New York Times revealed. Legislators in New Jersey held hearings on the matter this week.

After a postrecession lull, the so-called private loans — which generally have less favorable rates and terms than federal loans, and tend to require co-signers — are making a comeback of sorts. About one in 10 undergraduates takes one out, according to Sallie Mae, the biggest lender. Undergraduate and graduate students together borrow $10 billion to $12 billion in new private loans each year, according to MeasureOne, a market research and consulting firm, and the trajectory has been upward since the 2010-11 school year.

The $102 billion in outstanding private student loans make up just 7.5 percent of the $1.36 trillion in total student loan debt; the rest is made up of federal student loans. Undergraduates, however, can borrow only so much each year from the federal government before hitting limits.

So for anyone who wants to borrow more, there are the private loans, which usually come from Sallie Mae, banks and credit unions or other entities. The Consumer Financial Protection Bureau has a helpful guide on its site that explains the difference between federal and private loans in some detail.

Most private lenders require borrowers to have a co-signer to get a loan at all or to get a better rate. During the 2015-16 academic year, 94 percent of new undergraduate private loans had a co-signer, while 61 percent of graduate school loans did, according to MeasureOne's analysis of data from six large lenders that make up about two-thirds of the overall market.

Private student loans are popular enough that Amazon, in a rare foray into financial services, partnered with Wells Fargo last month just to offer better interest rates to students who are members of the retailer's Prime service.

Tempted to help out by lending your signature and good credit history to someone? Your participation could indeed make a difference. Credible, an online loan marketplace, examined about 8,000 loans and found that undergraduates looking for loans who had co-signers qualified for loans with (mostly variable) interest rates averaging 5.37 percent. Students flying solo got a 7.46 percent quote.

For graduate students, the numbers were 4.59 percent for duos and 6.21 percent for people going it alone. For its average undergraduate loan — $19,232, paid off in

eight years — the savings over time would be $1,896, which comes to about $20 a month.

But co-signing comes with plenty of risk. The Consumer Financial Protection Bureau outlined a number of them in a report it issued last year. In theory, most lenders provide a process by which the co-signer can be removed from the loan at the primary borrower's request.

Perhaps the biggest concern for co-signers ought to be the bureau's assertion last year that lenders turn down 90 percent of the borrowers who apply for these releases. The bureau's director, Richard Cordray, described the process as "broken."

But Sallie Mae said that more than half of its borrowers who make this request succeed. For PNC, the figure was 45 percent for the last 12 months. Citizens Bank reported a 64 percent number, while Wells Fargo said so few people had asked for a release that it did not track the number. (It's possible that many don't know that it's possible, as the bureau chided lenders for not making the rules clear.)

What accounts for this gap? The bureau's sample includes many loans that the original lenders sold to investors. These anonymous loan owners may not have the same incentive to be customer-friendly as big-name banks.

Some co-signers can't get a release because the primary borrower doesn't have sufficient income or a good enough credit score — fair and square. But sometimes it's neither fair nor square. The bureau reports numerous instances where people make several months' worth of payments in a lump sum but then don't get credit for the consecutive monthly payments that some lenders use to keep score on people who are aiming to release their co-signers.

Worse still, co-signers who make payments themselves may discover after the fact that the lender requires the primary borrower to make years of on-time monthly payments before it will consider a release. So efforts by the co-signer to help the primary borrower stay on track may foil their very attempt to get themselves off the loan later.

There are rarer horrors, too, where the death or the bankruptcy of the co-signer causes an automatic default, according to the bureau. At that point, a mourning child can receive a bill for the full balance, and debt collectors may chase after the executor of the estate for a dead grandfather who co-signed a loan years ago. The big banks that offer private student loans say they do no such things.

As for more likely events, like credit-sullying late payments, just 4.37 percent of borrowers were at least 30 days late on their loans at the end of the first quarter, according to MeasureOne's look at the big private lenders. But it's not necessarily the same 4.37 percent who are overdue at any given moment. Moreover, that number will go higher during the next downturn, and there might be more than one bad economic cycle during any individual's tenure as a co-signer.

A CreditCards.com survey of people who had co-signed on loans of all sorts found that 38 percent ended up paying at least some money, 28 percent were aware of damage to their credit and 26 percent saw relationships suffer as a result.

So where does this leave someone trying to help and tempted to co-sign? The tough-love reply goes like this: If you need a private loan as an undergraduate especially, then your college of choice is simply not affordable. Federal loans plus savings and current income should be enough to pay all of your costs, and if they aren't, then it's community college and living at home for you. And no, we won't take the debt on in our names only or yank money from home equity, since we need to think about retirement and not be a burden to you later.

But can you really bring yourself, as a parent in particular, to deny a teenager or an ambitious graduate student a shot at the better opportunities that a more prestigious and expensive school might bring, as long as the debt isn't outsize? Even an aspiring engineer who will earn plenty?

Many people simply will not be able to say no. So a few words for them. First, keep in mind that the teenagers you're betting on may never graduate. And if they don't, the odds are higher of the co-signer being liable for the private loan while the college dropout earns a modest hourly wage. So be especially wary if you think there is even a chance that your child or grandchild is not committed to college.

Finally, look the primary borrower in the eye and draw out a commitment of total and utter transparency. “Don’t assume that the primary borrower is making the payments, and make sure you have an open enough dialogue that they will tell you about it before they miss that payment,” said Dan Macklin, co-founder of SoFi, a company that helps many people refinance older student loans. “I’ve seen too many people where it’s an embarrassment and not spoken about, and it’s not very healthy.”

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