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In student loans, death need not equal default

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May 2007

Scandals, interest rate competition, readily available internet comparison shopping, and greater public scrutiny have pressured lenders to develop novel loan options to enhance or maintain market share.

One new option is debt cancellation in the event of death or permanent disability of the borrower. A variant of this provision already exists in many federally backed loans, but it's only recently gaining traction in private student loans.

Why would it be attractive to your students? By selecting a loan with a debt cancellation feature, students and their families will not be facing collection calls or burdened with a large debt repayment following a death or disability.

But wait. Don't lenders already have access to default insurance to address this situation? The answer is "not really." To perfect a default insurance claim, the lender must first make a claim against the estate of the deceased. If the estate is unable to repay the outstanding loan, then the lender must attempt to collect from the co-signers (usually the deceased's parents or spouse). Only then can a lender make a claim under Default Insurance (which on average only yields 80% to 90% of the loss amount).

How often do young, healthy students die during the life of their loans? According to *Injury Facts 2002 Edition*, published by the National Safety Council, for every 100,000 persons age 15 to 24, 81 will die each year. Between the ages of 25 to 34, another 108 will die each year. Therefore, for every 100,000 borrowers over a 20 year loan repayment period, debt cancellation will benefit nearly 2,000 families. These statistics do not take into account increased risk due to shootings such as at Virginia Tech.

One example may be helpful. In a recent bus accident, 20 college students in Illinois were killed. The state of Illinois faced the unenviable task of notifying each family that the student loans were immediately in default. As a fiduciary of the state, program administrators had to pursue these claims vigorously. Debt cancellation provisions would have eliminated this distasteful process.

The cost of debt cancellation coverage due to death or disability is reasonable. The present value of monthly premiums over a 20 year loan may approach 1% to 1.25% of the loan value. This cost may be consolidated into the closing costs at loan inception or shared between the lender and student.

Overall, the new debt cancellation benefit offers an interesting new tool to reduce administrative headaches, generate greater value to students, and better stabilize bottom-line profit figures for lenders, a win-win situation for all concerned.

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