AN UNDUE HARDSHIP? DISCHARGING EDUCATIONAL DEBT IN BANKRUPTCY

HEARING

BEFORE THE

SUBCOMMITTEE ON
COMMERCIAL AND ADMINISTRATIVE LAW

OF THE

COMMITTEE ON THE JUDICIARY
HOUSE OF REPRESENTATIVES

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SEPTEMBER 23, 2009

AN UNDUE HARDSHIP? DISCHARGING EDUCATIONAL DEBT IN BANKRUPTCY

WEDNESDAY, SEPTEMBER 23, 2009

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON COMMERCIAL AND ADMINISTRATIVE LAW,
COMMITTEE ON THE JUDICIARY,
Washington, DC.

The Subcommittee met, pursuant to notice, at 1:10 p.m., in room 2141, Rayburn House Office Building, the Honorable Steve Cohen (Chairman of the Subcommittee) presiding.

Present: Representatives Cohen, Conyers, Watt, Franks, Coble, and King.

Staff present: (Majority) James Park, Counsel; Andrés Jimenez, Professional Staff Member; (Minority) Zach Somers, Counsel; and Jennifer Lackey, Staff Assistant.

Mr. COHEN. This hearing of the Committee on the Judiciary, Subcommittee on Commercial and Administrative Law will now come to order. Without objection, the Chair will be authorized to declare a recess of this hearing. I will now recognize myself for a short statement.

Today we examine the conditional dischargeability of student loan debt in bankruptcy with a particular emphasis on the discharge of private, non-federally guaranteed or subsidized student loans. Congress has not held a hearing on the student loan dischargeability provision of the Bankruptcy Code since its first enactment in 1976, which was an amendment to the Higher Education Act, nor have they considered the 2005 extension of this provision to private student loans in particular.

In light of the rising cost of obtaining higher education, and particularly in light of the increase in the relativity—relatively unregulated private student loan market, such an examination is long overdue. We both see these higher costs of higher education and people having more difficulty securing second jobs and whatever necessary to help them through college, and then a difficulty getting jobs once they are out to use their education.

Unlike other kinds of unsecured debt, the Bankruptcy Code conditions the discharge of student loan debt on a debtor showing that he or she will suffer an undue hardship if forced to repay the loan. Congress' rationale, if there is such a thing, for giving student loan creditors favorable treatment in bankruptcy was to protect the viability of the Federal student loan program and more generally, public monies.

Four years ago, Congress went beyond Federal money protection and extended this type of favorable, unusual treatment to a private student loan, without any rationale expressed or claimed, no empirical evidence supporting such an extension. It is understandable why we want to have some level of support for our own loan program, but for those less favorably offered private, there was no particular reason except that BAPCPA, in 2005, kind of took in a—the entire sink of what people desired to have in the law, and that is what happened.

Access to education has been one of the defining issues of my legislative career, which has lasted now through 3 decades. As a Tennessee senator I fought 18 years to establish the Tennessee Lottery, which provides Hope Scholarships, as in Georgia, to young people who meet certain criteria and gives them scholarships—over $1.5 billion thus far since the program was initiated in 2004.

These scholarships have done a lot for students in Tennessee, but they need other monies as well to make it through college, and the scholarships we have in Tennessee—the Hope Scholarships—help folks make it who otherwise might not be able to afford it, and there is a merit portion and a need-based portion.

Given this history of championing access to higher education of students of modest means, I view with concern the great increase in the number of private student loans issued over the last decade. Ostensibly, these types of loans, which are not Federal guaranteed or subsidized, could provide greater access to a college education for those who may not qualify for Federal loans or who would otherwise not be able to afford college education. However, recent studies suggest that the access that private student loans could provide may bring costs that outweigh their benefits.

Private student loan borrowers often find themselves trapped under the weight of tens of thousands of dollars in expensive, high-interest hefty student loan debt with no guaranteed opportunity for income-based repayment, deferment, or forbearance. It was these types of loans that caused me to condition Tennessee's lottery program on repaying college debt, for I have seen too many people in my private practice who had high debt and were—and had one foot in bankruptcy while struggling to get their debt paid off, which would never have come to an end.

Unlike Federal student loans, private loans lack consumer protections and any hope of having a job later, leaving financially distressed borrowers with little option but to seek bankruptcy relief. Some commentators have suggested that such bankruptcy relief may be too difficult to obtain, or at least that obtaining discharge may be haphazard. Professor Rafael Pardo, one of our witnesses today, has conducted empirical studies suggesting that similarly situated student loan debtors may receive different outcomes with respect to their attempts to discharge student loan debt.

Non-legal factors, such as the experience level of the debtor's attorney or the identity of the judge often determine the outcome of the discharge request, raising questions about whether the undue hardship standard is really a workable one.

Kind of reminds me of Barry Scheck yesterday.

I thank our witnesses for being here today, and I look forward to their testimony and maybe seeing why these student loans are put in a special category otherwise reserved for things like fraud, child support, alimony, and primary home mortgages.

I now recognize my colleague, Mr. Franks, the distinguished Ranking Member of the Subcommittee, who has offered to forego this hearing but his offer was not accepted——

Mr. FRANKS. Well, thank you, Mr. Chairman. Mr. Chairman, last week on a largely party-line vote, the House in full session passed H.R. 3221, the Student Aid and Fiscal Responsibility Act. The fiscal responsibility confuses me, but be that as it may.

This legislation is a dramatic shift away from private studentlent board consolidation of Federal power over higher education financing. In fact, today we—in fact, according to the *Time* magazine, the Administration's proposal to restructure the student loan industry is, according to them, much closer to an actual government takeover than its health care reform plan.

The passage of H.R. 3221 in the House makes today's hearing, in my judgment, especially troubling. If H.R. 3221 isn't the death knell of private student lending, ending the favorable treatment that private student loans receive under the Bankruptcy Code certainly could be.

Since 1976 Congress has gradually increased the protections that Federal nonprofit and for-profit student lenders receive under the Bankruptcy Code. Some would like to see these bankruptcy protections erased, especially with regard to privately-issued student loans.

However, Mr. Chairman, privately-issued student loans increase access to education by providing a source of funding to those that need to borrow more than the Federal student loan limits allow. Additionally, private-issued student loans allow lenders to tap into billions of dollars in private capital. Now if private capital, maybe we should toss in here just the definition: Private capital is that capital that the Federal Government doesn't have to borrow from abroad to fund our Nation's educational system.

Critics of the special bankruptcy protection student loans receive—that student loans receive point to the high costs of higher education that lead many students to incur substantial debt as they try to put themselves through school, and I understand that, but college affordability and the cost of student loans are issues Congress should indeed try to address, but allowing student loans to be unconditionally dischargeable in bankruptcy is not a solution to those problems.

If we make student loans unconditionally dischargeable we will encourage abuse, increase the interest rates students pay on their loans, and dry up the flow of capital into the student lending market. This will either decrease access to higher education or create a vacuum the Federal Government will have to fill again at taxpayer expense.

Now, I suspect, of course, that the push to make privately-issued student loans unconditionally dischargeable is part of a broader effort to replace all privately-issued student loans with government loans. But Mr. Chairman, just as we do not need a single-payer health care system, we do not need a single-lender higher education system.

There is no reason to crowd private lenders out of the student loan market, either directly through legislation like H.R. 3221 or indirectly through changing the bankruptcy rules that apply to student loans. Yes, Mr. Chairman, the government should regulate private student loans to eliminate any abusive lender practices, but the real culprit here is the rapidly rising cost of higher education, which has been escalating way beyond the general rate of inflation.

Making private sector loans dischargeable in bankruptcy will do nothing to solve college affordability problems. And ultimately, Mr. Chairman, I would like to say sometimes that your future generations are watching. Because I truly believe that in the long run, when we as government come in and try to think that somehow our power can repeal the laws of mathematics and make private lenders just suddenly do the same thing that they have always been doing, even though there is greater risk to them, it just doesn't happen that way.

I know it is a good theory, but someone said that there is nothing more tragic in this world than a beautiful theory that is totally destroyed by an unruly set of facts. And unfortunately, the effect of both this legislation that we have discussed and this bankruptcy concept that we are discussing will be to drive capital away from the ability to help finance education, and I believe that that will hurt students in the long run.

And unfortunately, Congress doesn't have the power to do anything to repeal that mathematical equation except to inject taxpayer dollars into the equation, and sooner or later there will be a day of reckoning. I submit that it is probably already here and we don't know it.

With that, I look forward to the witness' testimony and yield back the balance of my time. Thank you, Mr. Chairman.

Mr. COHEN. Thank you.

I thank the gentleman for his statement and for looking forward to the witness' testimony. I now recognize Mr. Conyers, the distinguished Member of the Subcommittee, for his opening statement and the Chairman of the Committee on the Judiciary.

Do you have an opening statement or would you like to waive?

Mr. CONYERS. Well, I will partially waive it, Mr. Chairman.

Just to greet Danny Davis and to commend him for the great work that he has done in the course of his career. I mean, it is not anybody that can get President Bush to sign a bill we thought he didn't like, and there we were in the White House up there with President George W. Bush just like it was the normal way we do business around here.

So I commend him for his tenacity. I knew Danny Davis when he wasn't a congressman, and I think that this idea is very important.

And the reason I only need a minute is that I have started thinking about what is so different about discharging student loans that is different from discharging everything else that is dischargeable? I mean, this isn't a gambling debt; this isn't something that is against the common good or against the general welfare.

Credit cards are dischargeable. I don't hear anybody ranting about that. You rant about it too. You rant, "Okay, well that is good." Consistency is the hot button of great minds.

And what about mortgages being discharged in bankruptcy? Your yacht is dischargeable in bankruptcy. Your vacation resort place is dischargeable in bankruptcy. Your second or third home are all dischargeable in bankruptcy.

Then you get to, what are these people doing trying to get an education and run into trouble and they go to the bankruptcy judge? Well, no. The door is closed. After all, in 1976 we said, "Enough of this government-funded guaranteed student loans being made dischargeable. We are changing that."

Well, my colleagues weren't even here in 1976, so I can't even blame them for it. Matter of fact, they could blame me for it. I was here.

So I think Congressman Davis asking us to take another look at this is a good idea, and I will put my statement in the record.

[The prepared statement of Mr. Conyers follows:]

PREPARED STATEMENT OF THE HONORABLE JOHN CONYERS, JR., A REPRESENTATIVE IN CONGRESS FROM THE STATE OF MICHIGAN, CHAIRMAN, COMMITTEE ON THE JUDICIARY, AND MEMBER, SUBCOMMITTEE ON COMMERCIAL AND ADMINISTRATIVE LAW

Obtaining higher education is the key to economic security and a better future. For our youth, it may present the only way out of a life of poverty.

And for many middle class Americans facing unemployment, returning to school to be retrained for a new profession may be their best way to getting back into gainful employment.

Unfortunately, changes made to our bankruptcy laws have made getting a higher education more difficult, in ways that may not have been understood.

Let me explain. As originally conceived, our Nation's bankruptcy system was intended to offer a financial fresh start to honest, hardworking Americans.

It helped encourage people to reach for goals like obtaining a higher education, while giving them some assurance that, should fate pull the rug out from under them, their debts will not be permanently devastating, that they will still have a fair chance at the American Dream.

Encouraging people to reach for their goals benefits our entire society.

But, Congress has passed a series of amendments over the years that have had the effect of substantially weakening the scope and value of that fresh start. And that is particularly true with regard to debts incurred for education.

Beginning in 1976, certain types of government-funded and government-guaranteed student loans were made nondischargeable in bankruptcy, with various exceptions.

In the ensuing years, Congress passed amendments that gradually limited the exceptions, so that increasingly more types of government student loans became nondischargeable.

With the enactment of the mis-named Bankruptcy Abuse Prevention and Consumer Protection Act in 2005, an entirely new category of educational loans were made nondischargeable, placing the financial fresh start even further out of reach.

As a result of this amendment, certain privately funded student loans can no longer be discharged in bankruptcy.

As I recall, this particular amendment was never the subject of any formal Congressional hearing.

Thus today, four years later, we finally consider for the first time whether this latest move was a mistake, and whether we should make it a bit easier to discharge private student loans in bankruptcy.

With respect to the perils of private student loans, however, we have, in a broad sense, heard this story before.

I fear that, as with the lending industry's aggressive marketing of subprime mortgages—which drove increases in home purchases for much of the last decade, only to result in the onset of the home foreclosure crisis—the long-term costs of using private student loans, both for the borrower and perhaps for our Nation's economy, may simply be too high.

While not a perfect analogy, I see at least three possible similarities between private student loans and subprime mortgages that give me pause.

First, both private student loans and subprime mortgages are subject to high interest rates and fees, leaving many borrowers with unaffordable debt that may ultimately push them into bankruptcy.

Private student loans—like subprime mortgages and unlike federal student loans—typically have variable interest rates.

I'm told that some of these initial rates can be as high as 19%, and that some lenders have no maximum limit on the interest rates they charge students.

Borrowers, as a result, are completely subject to the whim of their lenders.

As with subprime mortgages, many student loan borrowers are young persons with little or no credit history or sometimes with less than stellar credit histories, which makes it easier for lenders to charge them the worst interest rates.

Mark Kantrowitz of Finaid.org observed that 75% of student loan borrowers receive the worst interest rates, while only 10% receive the best.

Similarly, there are no limits on the amount or types of fees that a private lender can charge, adding to the cost of private student loans.

Second, both private student loan borrowers and mortgage borrowers find that they are having difficulty in their interactions with lenders and servicers.

As in the mortgage industry, the private student loan servicer is usually the one who interacts with the borrower, although the servicer is very often a step removed from the loan lender.

Just like mortgages, private student loans are usually repackaged and sold to investors, who then have yet another financial interest in the loan.

As with mortgagors, student loan borrowers complain of improper billing procedures and fees, and a lack of responsiveness to requests for information or assistance by troubled borrowers.

Private student loan lenders, like many mortgage lenders, have demonstrated an unwillingness to provide flexibility in modifying loan terms, such as allowing for income-based repayment, or providing even partial forgiveness for distressed borrowers.

Third, some private student loan lenders, like some mortgage lenders, may be engaging in what could be characterized as "reverse redlining." In effect, these lenders steer low-income and minority borrowers into higher interest rate loans.

Such predatory lending raises the prospect that student loan borrowers will bear the brunt of a new loan default crisis similar to the home mortgage foreclosure crisis.

Two weeks ago, this Subcommittee held a hearing on the role of the lending industry in the home foreclosure crisis. One of the witnesses, Baltimore City Solicitor Suzanne Sangree, told us about her city's lawsuit against Wells Fargo, the Nation's largest mortgage lender.

The lawsuit alleged that Wells Fargo deliberately steered African-American borrowers towards high-cost subprime mortgages regardless of whether the borrower qualified for better loan terms.

The result has been that home foreclosures have disproportionately hit predominantly African-American neighborhoods very hard.

A similar kind of allegation has been leveled against the Nation's largest private student loan lender, Sallie Mae. Two Florida student loan borrowers allege that Sallie Mae charged higher interest rates for minority borrowers, even though they may have qualified for lower rate loans.

Student loan lenders admit that the borrower's school is a factor in determining interest rates for a student loan. Lenders charge higher interest rates for schools with high default rates.

Unfortunately, schools with a large proportion of minority students tend to have higher default rates than schools generally.

The result, therefore, may be that lenders are effectively taking into account impermissible criteria like race in setting unfavorable interest rates and other terms for minority borrowers.

How should we respond to these concerns? In contrast to a home mortgage, student loan debt is unsecured debt. Generally, unsecured debt can be discharged in bankruptcy.

However, the Bankruptcy Code currently conditions the discharge of student loan debt on the debtor showing that she would suffer an undue hardship if she had to repay her student loans.

So one possible response to concerns about private student loans is to reform the Bankruptcy Code to make it easier to discharge private student loan debt.

Last year, I voted for an amendment to the Higher Education Opportunity Act introduced by Representative Danny Davis, which would have made a very modest amendment to the Bankruptcy Code with respect to the dischargeability of privately-funded student loans.

Essentially, debtors would have been able to discharge those student loan debts where they had been in repayment for more than five years. This amendment would have provided some relief for debtors overwhelmed by high-cost private student loans.

While I was disappointed that the amendment was not adopted, I am hopeful that testimony from today's hearing will demonstrate why that change is necessary.

I thank Chairman Cohen for holding this hearing today on the topic of discharging private student loans in bankruptcy. I also thank our witnesses, and look forward to their testimony.

Mr. COHEN. Thank you, Mr. Chairman. I appreciate your statement and don't hold you responsible for the other 434 people in 1976.

Without objection other Members' opening statements will be included in the record. I would like to thank all the witnesses for participating in today's hearing, and without objection your written statements will be placed in the record.

[The prepared statement of Mr. Johnson follows:]

PREPARED STATEMENT OF THE HONORABLE HENRY C. "HANK" JOHNSON, JR., A REPRESENTATIVE IN CONGRESS FROM THE STATE OF GEORGIA, AND MEMBER, SUBCOMMITTEE ON COMMERCIAL AND ADMINISTRATIVE LAW

Thank you, Mr. Chairman, for holding this very important hearing on the Bankruptcy Code's conditional discharge provision for student loan debt, specifically the issue of discharging private student loans in bankruptcy. It is imperative that we examine the issue of discharging private student loans in bankruptcy, particularly in light of the record breaking unemployment numbers that we have seen in this economy. This is the same economy that is causing everyday Americans to go bankrupt in order to meet basic needs. One of these needs, repaying student debt is particularly contentious.

Student loans are unsecured debt and unsecured debt is typically dischargeable in bankruptcy. However, the Bankruptcy Code has a specific carve out that does not exempt student loans unless a debtor is able to demonstrate that continued repayment of the debt would impose an "undue hardship" on the debtor. In essence, this means that current bankruptcy law treats students who face legitimate financial distress the same severe way as people who are trying to discharge child support debts, alimony, overdue taxes and criminal fines. We are not discussing tax evaders or absent fathers. We are talking about unfairly penalizing adults who twenty years ago, as naíve and financially unsophisticated 17 year olds, agreed to the dense and confusing terms of a private loan agreement in order to get an education and contribute to our society. And unlike with federal loans, these individuals are often unable to work out terms that ensure a reasonable and fair repayment schedule.

The witnesses' testimony today will make clear that questionable practices have been used in providing private educational loans. As the witnesses will state today, private loans are aggressively marketed to students simply seeking education. It would be absurd for us to pretend that every teenager in this position can reasonably be expected to comprehend what they are agreeing to. Even if they do understand, I question whether two thirds of these students know that they were eligible for additional federal loans. These federal loans contain mechanisms to ensure repayment without excessive financial distress on the part of the borrower. I also question whether these students are aware of the egregious racial disparities that exist in lending. For example, my colleague from Illinois, Congressman Davis will attest to how lending terms can be based on characteristics independent of one's financial viability.

In short, we have a responsibility to ensure that lenders are ethical in issuing these loans, and are only able to do so after adequately informing the debtor of what they are agreeing to. We ensure repayment by holding private lending companies accountable: we must require the same repayment and distress options as federal loans, if we provide the same protections as federal loans. Such guidelines permit education lenders to reap a larger percentage of the original principal and guarantees Americans access to education when they need this support the most.

Thank you, Mr. Chairman, for scheduling this hearing. I look forward to hearing from the witnesses and I yield back the balance of my time.

Mr. COHEN. And before we go into all that I would like to introduce our first panel, which is a singular panel. Congressman Danny Davis, who has been introduced already to some extent by the Chairman, and in a way beyond what I could do to recognize him. He represents the 7th congressional district of Illinois.

Currently, Representative Davis serves on Committee on Ways and Means and the Committee on Oversight and Government Reform. He is a member of the Congressional Black Caucus, co-chairman of the Community Health Center's Caucus, co-chairman of the Congressional Sugar Caucus, and the Progressive Caucus, and a man I am fortunate to serve with and know as congressman. And I look forward to the day that I know him as something else.

Thank you, Mr. Davis. You may begin your testimony.

TESTIMONY OF THE HONORABLE DANNY K. DAVIS, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF ILLINOIS

Mr. DAVIS. Thank you very much, Chairman Cohen, Ranking Member Franks, Chairman Conyers, Mr. Watt, Mr. Coble, all the Members of the Committee. I thank you for holding this hearing to examine the hardships associated with the inability to discharge one's private educational debt via bankruptcy

As a co-chair of the Community Reinvestment Taskforce within the Congressional Black Caucus, I thank you for the opportunity to voice the concerns of the taskforce members about the hardships associated with the non-dischargeability of these debts and the likely disproportionate effect of this policy on African Americans. Two studies released in August raised concerns for the members of CBC's Community Reinvestment Taskforce with regard to the bankruptcy protection afforded to private educational debt.

A study by the Project on Student Debt found a dramatic increase in the use of private student loans and that African American students were statistically more likely than other students to borrow such loans, with the percentage of African American private loan borrowers quadrupling from 4 percent to 17 percent in the last 4 years. In addition, an analysis by Moody's Investment Service found that private loans made directly to students tend to have higher default rates.

Together, these reports indicate that tens of thousands of students, and especially African American students, are relying on private, non-Federal educational loans that lack basic consumer protections and that receive statutory protection from bankruptcy except under extreme circumstances, making these borrowers much more likely to experience financial hardship associated with private educational debt.

In addition to these studies, I have many personal stories from borrowers who bettered themselves via education only to experience tremendous economic hardship associated with their private student loans, including Mandy, from Illinois, and Laurie, from Ohio. Shockingly, one lender's representative jokingly suggested that Laurie and her husband could sell their kidneys to help pay off the loan.

The hardships associated with these debts and our bankruptcy policies are neither funny nor simply business. They are significant burdens to our citizens. Our concerns over the privilege afforded to private education lenders are heightened by data last week showing that racial disparities in lending exist even for high-income borrowers earning over $100,000.

As policymakers, we want to ensure that our statutes do not unintentionally burden particular groups of people. Private education debt is no different than any other consumer debt. It involves private profits and deserves no privileged treatment. The members of the Community Reinvestment Taskforce are concerned that current bankruptcy law penalizes borrowers for pursuing higher education, provides no incentive to private lenders to lend responsibly, and possible affects African American borrowers more negatively than borrowers from other racial and ethnic groups.

And so, Mr. Chairman, again I want to thank you and Members of the Committee for the opportunity to be here to share these concerns and to testify before the Committee. I thank you very much and yield back the balance of my time.

[The prepared statement of Mr. Davis follows:]

PREPARED STATEMENT OF THE HONORABLE DANNY K. DAVIS, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF ILLINOIS

TESTIMONY OF CONGRESSMAN DANNY K. DAVIS BEFORE
COMMITTEE ON THE JUDICIARY
SUBCOMMITTEE ON COMMERCIAL AND ADMINISTRATIVE LAW
HEARING ON AN UNDUE HARDSHIP? DISCHARGING EDUCATIONAL DEBT IN BANKRUPTCY
SEPTEMBER 23, 2009

Chairman Cohen, Ranking Member Franks, and Members of the Subcommittee, I thank you for holding this hearing to examine the hardships associated with the inability to discharge one's private educational debt via bankruptcy. As a Co-Chair of the Community Reinvestment Taskforce within the Congressional Black Caucus (CBC), I thank you for the opportunity to voice the concerns of the Taskforce Members about the hardships associated with the non-dischargeability of these debts and the likely disproportionate effect of this policy on African Americans.

As Members of Congress active in education policy, the Community Reinvestment Taskforce Members strongly support ensuring that students have the money they need to attend institutions of higher education. Most students and families use federal loans to pay for college. However, certain groups of students may require private student loans to attend school, such as students who need to borrow more than is available federally, students who attend schools that do not participate in the federal loan program, and international students. Unlike federal student loans, private student loans typically lack any form of consumer protection, such as fixed interest rates, income-contingent and income-based repayment options, or debt discharge in the case of disability or death. For these reasons, lenders and financial aid experts generally agree that students should exhaust federal financial aid prior to using private loans.

Private educational loan lenders enjoy federal protections from bankruptcy that other consumer creditors do not. Specifically, unlike other types of consumer debt, private student loans are protected from discharge during bankruptcy except under extreme circumstances. Thus, an individual who accumulates thousands of dollars in debt for purchases of cars or luxury goods can obtain relief via bankruptcy; however, a teacher with private student loans cannot. Only a handful of consumer debts cannot be discharged via bankruptcy, namely criminal fines, back taxes, child support, and alimony. There also is a non-dischargeability provision for federal student loans given that these loans have multiple consumer protections and routes for discharge built into them.

Two studies released in August raised concerns for the Members of CBC Community Reinvestment Taskforce with regard to the bankruptcy protections afforded to private educational debt. In late August, a study by the Project on Student Debt indicated a dramatic increase in the use of private student loans by undergraduates today than four years ago. The study showed that the percentage of undergraduates relying on private educational debt almost tripled from 5% in 2003-2004 to 14% in 2007-2008. Further, in 2007-2008, approximately two-thirds (64%) of the students with private loans under-borrowed federal loans, up from 48% in 2003-2004. Although students from all races and ethnicities were equally likely to turn to private loans before exhausting their federal loans in 2007-2008 and although all racial and ethnic groups increased their borrowing of private educational debt, African American students were statistically more likely than other students to borrow private student loans in 2007-2008, with the percentage quadrupling from 4% to 17% in the last four years. It is of great concern that tens of thousands of students, and especially African American students, are relying on loans that, in addition to a dearth of basic consumer protections, receive statutory protection from bankruptcy except under extreme circumstances.

Concern for these borrowers is heightened even more by the report issued by Moody's Investment Service in mid-August that found that private loans made directly to students tend to have higher default rates. The analysis is simply entitled: "Direct-to-Consumer" Student Loans: Higher Risk". The report explains that these direct-to-consumer loans – or private educational loans that do not go through a college or university – lack the safeguards of "school-channel loans," including: requiring verification that the student is enrolled, certification that the loan amount is what is needed and allowable, and disbursement of the funds to the institution first to cover primary educational debts. These safeguards lessen the likelihood that students will take on excessive debt and will use the funds for purposes other than education. Interestingly, even when factors related to underwriting and servicing were held constant, Moody's found that the private, direct-to-consumer loans had higher correlations with loan default. Direct-to-consumer loans by First Marblehead were approximately 2.9 times as likely to default as their private loans that went through school the institutions of higher education, and Sallie Mae's direct-to-consumer loans were approximately 1.3 times as likely to default as their private, school-channel loans. Together, these reports indicate that tens of thousands of students - especially African American students - are more likely to experience financial hardship associated with private educational debt.

In addition to these studies, I have many personal stories from borrowers experiencing trouble repaying their private loans, especially during this economic downturn. The variable interest rates have caused their loans to balloon, and they are overwhelmed by the lack of options offered by the private lenders to set manageable payments. They confide that they have even considered bankruptcy as a last resort to help them manage the debt, only to learn that this avenue is closed. I ask to submit for the record an article from the *Chicago Sun-Times* from May 2007. This article describes the cases of people from Illinois who experienced tremendous hardship from their private loans, even before our current economic crisis. I also ask to submit to the record a statement by Laurie White from Youngstown, Ohio. Laurie called my office this past July. Having heard my name raised as someone concerned about the lack of consumer protections in private educational loans, she called to see if any legislation was on the horizon that could help her. She tearfully explained how Tuition Answer Loans (a division of Sallie Mae) required her to pay more than half of her family's monthly income for her private loans. She discussed how extremely frustrated she was by the lack of information provided about her loans by the representatives and the lack of alternative payment plans or avenues to make her debt more manageable. She indicated that her husband had to change jobs due to a disability, and she had not been able to find a job after completing a degree a program to become a surgical technologist. It was only after my staff referred her to the office of Senator Sherrod Brown, whose staff put her in contact with the Sallie Mae Student Advocate Service, that Laurie learned she could pay $150 every three months for up to fourteen months on top of her variable interest rate of 9.5% to defer her payments.

As Members of the Community Reinvestment Taskforce, our concerns over the privilege afforded to private educational lenders are heightened by data showing that racial disparities in lending exist. Last week, the Center for American Progress released a study of lending rates by many of the nation's prominent banks based on data from loan disclosures under the Home Mortgage Disclosures Act. The report reveals that lenders charged higher mortgage rates for minority borrowers, even for borrowers earning twice the median income for their areas. Even among high-income borrowers (almost all of whom earned over $100,000), Latino and African American borrowers were considerably more likely to receive higher mortgage rates than white borrowers. Specifically, 29 percent of Latino borrowers and 32 percent of African American borrowers received higher-priced loans, in contrast to only 10.5 percent of white borrowers. The report is a reminder that disparities in lending occur, even for high income earners.

As policymakers, we want to ensure that our statutes do not unintentionally burden particular groups of people. There is a societal benefit to ensuring that people pay criminal fines, back taxes, and child support. The societal benefit of denying a borrower with thousands of dollars of private education debt the opportunity to restructure that debt via bankruptcy when faced with financial hardship, but allowing someone with the same amount of material debt to do so, is unclear. Private education debt is no different than other consumer debt. It involves private profit and deserves no privileged treatment. The Members of the Community Reinvestment Taskforce are concerned that current bankruptcy law penalizes borrowers for pursuing higher education, provides no incentives to private lenders to lend responsibly, and possibly affects African American borrowers more negatively than borrowers from other racial and ethnic groups.

As the representative of the CBC Community Reinvestment Taskforce, I thank you for your thoughtful examination of this issue and for the opportunity to share the concerns of our Members about the hardships associated with current policy and the disproportionate impact on African American borrowers. Further, I respectfully ask you to consider restoring bankruptcy protections to private student loan borrowers to what is currently afforded other unsecured debtors, as was the case before 2005.

Mr. COHEN. I want to thank Congressman Davis for his testimony and for his amendment he offered last year that I was happy to support, glad to support. Are there any questions from any Members of the panel for Congressman Davis?

Mr. FRANKS. Could I just thank Congressman Davis for being here? Notwithstanding in my earlier comments, I certainly laud your commitment to trying to do things that are motivated from the right point of view, and I thank you very much for being here, sir.

Mr. DAVIS. And I thank you very much, Mr. Franks, for your comment.

Mr. COHEN. Thank you, sir. I appreciate your bringing this issue to my attention last year with your timely amendment that was unfortunately not successful and your continued persistence. I appreciate your opening statement.

It looks like you are making some headway with my distinguished and great-mind Ranking Member, and so I think we will be working with the staff to try to bring some legislation. Hopefully it could be bipartisan, and if not, you know, we will just have to try to forge ahead and do what is right.

And with that, we thank you and you are dismissed, relieved, and allowed to vote, which we will soon join you.

We have got a vote in 15 minutes. I don't know if it is worth trying to start the second panel. We have got a second panel. We could try at least one witness——

The second panel, come on up. We will get started.

All right. Thirteen minutes for votes, so maybe we can get through at least one witness, maybe two, and we appreciate your being here.

I thank all the witnesses who are participating in today's hearing. Without objection your written statement will be placed in the record and we would like to ask you to limit your oral remarks to 5 minutes.

You have got a lighting system in front of you. You have got a button to push to turn your microphone on; light comes on green, that means you are between 5 and 1 minute; you are into your speech at 5 minutes and you have got at least more than 1 minute left, your yellow light means you are in the last minute, and red means you are supposed to finish and allow us to move on. After you present your testimony Subcommittee Members will be permitted to ask questions, again, the 5-minute rule.

And our first witness today will be Lauren Asher. Lauren Asher is a nationally recognized expert on student loans and financial aid with a very pleasant smile.

Ms. Asher is president of the Institute for College Access and Success, an independent, nonprofit organization working to make higher education more affordable and available for people of all backgrounds. The institute is home to the Project on Student Debt, which Ms. Asher helped found in 2005.

After serving in senior positions to the Kaiser Family Foundation National Partnership for Women and Families and U.S. Department of Labor, she founded and ran Asher Policy Consulting from 2002 to 2005. Her clients included foundations, national, state, and local nonprofits working to improve the lives of children, youth, and working families.

With such a background you are like Betty Crocker, I guess. Thank you for being here, Ms. Asher, and you may begin your testimony.

Mr. COHEN. Punch your button.

TESTIMONY OF LAUREN ASHER, THE INSTITUTE FOR COLLEGE ACCESS AND SUCCESS

Ms. ASHER. Can you hear me?

Mr. COHEN. We can hear you, and your green light is on which means you are running.

Ms. ASHER. Thank you.

Thank you, Chairman Conyers, Chairman Cohen, Ranking Member Franks, and all the other Members of the Subcommittee. I will skip my introduction since you have done it for me.

Post-secondary education is increasingly essential to both the future of our Nation and to individual Americans who seek to enter or remain in the middle class. However, as college costs have outpaced family incomes and available aid, more Americans have had to borrow for their education than ever before.

Two-thirds of all students who graduate from 4-year colleges now have student loan debt. Most have Federal student loans, but a growing number have private student loans as well or instead. Last year, one-third of all bachelor's degree recipients used a private student loan at some point before they graduated.

Private student loans are one of the riskiest ways to pay for college. They are expensive, mostly variable-rate loans that cost more for those who can least afford them. Private loans do not have the fixed rates, consumer protections, or flexible repayment options of Federal loans, they are not guaranteed by the Federal Government, are not part of the Federal student loan program, and are not financial aid any more than using a credit card to pay for tuition or books is financial aid.

Mr. COHEN. Don't worry about the alarm. Go ahead.

Ms. ASHER. Yet, despite how similar private loans are to credit cards and other consumer debt, since 2005 they have been treated very differently in bankruptcy. The 2005 bankruptcy reforms also made it significantly more difficult for anyone to declare bankruptcy while changing the treatment of private student loans as well. Today credit cards and other forms of consumer debt, even gambling debt, are dischargeable in bankruptcy, but private loans are non-dischargeable, along with Federal student loans, back taxes, child support, and criminal fines.

Borrowers who have already met the stringent test for bankruptcy must initiate a separate legal proceeding to prove to a judge that repaying their private student loans would create an undue hardship. As other witnesses will testify today, without a high-priced attorney this is virtually impossible to do, and even then the outcomes depend more on arbitrary factors, like the judge before you, than the merits of your case.

There are reasonable arguments for making Federal student loans at least somewhat harder to discharge in bankruptcy, although not necessarily as hard as criminal fines. For example, Federal loans are backed by taxpayer dollars. They offer some significant relief in situations of economic hardship, unemployment, death, disability, as well as payment plans like income-based repayment that can help borrowers meet their obligations and avoid default and bankruptcy.

Private student loans have none of these benefits and are commercial products. There is simply no justification for putting them in the same category as Federal loans in bankruptcy.

Giving the private student loan industry privileged treatment in bankruptcy is particularly inappropriate. Its predatory practices have targeted young people who have no financial experience with deceptive marketing, high-pressure sales tactics, and kickbacks to colleges for steering students to these high-priced loans.

Until Congress passed legislation last year, there were virtually no regulations to limit the dangers of private student loans. Prospective borrowers were not even entitled to information about the actual loan terms and costs before they had to sign the promissory note. Even today, private loans remain largely unregulated and the new congressionally-mandated disclosure requirements don't go into effect until next year.

Students and families should be able to count on their college financial aid offices for impartial advice about loans and lenders, and most can. However, over the past few years Federal, state, and independent investigations have exposed numerous conflicts of interest. College officials received gifts, trips, stock options, and other benefits from lenders. Some colleges agreed to recommend a lender for kickbacks on the loan proceeds.

In other cases, lenders staffed call centers and financial aid offices posing as college representatives while giving very biased advice about student loans. Legislation passed in 2008 was aimed at curbing such abuses but did nothing to help the unsuspecting student already saddled with these costly loans.

Shielding private loans from bankruptcy means that unaffordable repayment demands can extend literally forever, even after death. It may also make lenders less cautious about making loans to people who cannot afford them, such as low-income students at schools with low completion rates and job placement rates.

From 2006 to 2008, Sallie Mae increased its "nontraditional" subprime lending to students by 42 percent. As default rates soared and the financial market collapsed in 2008 Sallie Mae stopped making these loans, but thousands of American students were stuck with this high-cost debt.

In a particularly disturbing development recently revealed in an A.P. story, some large, for-profit colleges have started making their own private loans directly to the same high-risk students. For example, Corinthian Colleges plans to make $130 million of such loans this year alone, made $120 million last year, while telling investors that it expects nearly 60 percent—that is six-oh percent—of borrowers to default.

Ironically, private lenders remain fully eligible for the bankruptcy protection that their borrowers are now denied. The Education Resources Institute, Education Finance Partners, and My Rich Uncle all recently declared bankruptcy. They were able to make a fresh start regardless of why they failed. Their borrowers deserve the same fair treatment in bankruptcy.

Thank you for inviting me to testify today, and I welcome your questions.

[The prepared statement of Ms. Asher follows:]

PREPARED STATEMENT OF LAUREN ASHER

the institute for college access & success

Testimony of

Lauren Asher
President, the Institute for College Access & Success

Before the House Committee on the Judiciary
Subcommittee on Commercial and Administrative Law
Oversight Hearing Titled:
An Undue Hardship? Discharging Educational Debt in Bankruptcy

September 23, 2009
Washington, DC

Thank you for inviting me to testify today. I commend the Chairman and members of the Committee for recognizing the importance of how private student loans are treated in bankruptcy, which has never been addressed at a Congressional hearing before.

My name is Lauren Asher, and I am the president of the Institute for College Access & Success, a nonpartisan, nonprofit research and policy organization established in 2004. The Institute works to make higher education more available and affordable for people of all backgrounds, and our national Project on Student Debt focuses on trends in student loan borrowing and the implications for our families, economy, and society.

For the past few years, we have led a successful initiative to improve repayment options for federal student loans. This July, the new federal Income-Based Repayment (IBR) program, which was established by Congress in the College Cost Reduction and Access Act of 2007, went into effect. Based on a model we developed with support from both student and consumer advocates and the lending industry, IBR caps federal student payments at a manageable level based on the borrower's income and family size. It is available to borrowers with significant student loan debt relative to their income: for the most part, those who owe at least as much as they earn. In tough economic times like these, IBR can help responsible borrowers fulfill their obligations and avoid default without jeopardizing their ability to meet basic needs.

IBR is just one of the important borrower protections and repayment options that apply only to federal student loans, and not to the risky private student loans I am here to discuss today. Private student loans are mostly variable-rate consumer loan products offered by some banks and other lenders; they are not guaranteed by the federal government and have no relationship to the federal student loan programs.

Student debt in context

Post-secondary education and training have become essential to the future of our nation as a whole, and to individual Americans who hope to enter or remain in the middle class. As family incomes, available grant aid, and state investments in higher education have failed to keep pace with college costs, students and families have increasingly turned to student loans to help bridge the growing affordability gap.

Two-thirds (67%) of all students who graduate from four-year colleges now have loans, and their average student loan debt is $23,200. Graduates of public colleges and universities are not immune: more than three in five (62%) have loans, and their average debt is more than $20,000. Graduates of for-profit colleges are the most likely to borrow and borrow the most: nearly all (96%) have loans, and their average debt is $33,000.[1] These cumulative debt numbers, drawn from our analysis of the most recently available federal data, include both federal and private loans.[2]

While most undergraduate borrowers have federal student loans, a growing share has taken on private student loans in addition to, or instead of, safer federal loans. The proportion of all undergraduate students – in all sectors and all years of enrollment -- who took out a private student loan in 2007-08 was 14 percent, a dramatic increase from just four percent in 2003-04. As I will discuss further below, we have found that nearly two-thirds of undergraduates who borrowed private loans in 2007-08 had not exhausted their main federal borrowing option that year.

Looking just at those who graduate from four-year colleges, one third (33%) of all students who received a bachelor's degree in 2007-08 borrowed a private loan at some point before they graduated.[3] All of these numbers about student borrowing in 2007-08

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[1] From "Quick Facts about Student Debt." The Project on Student Debt. Available online at http://projectonstudentdebt.org/files/pub/Debt_Facts_and_Sources.pdf

[2] The U.S. Department of Education's National Postsecondary Student Aid Study (NPSAS) is a comprehensive nationwide survey conducted every four years, most recently in academic year 2007-08. The data it collects on private student loans refers only to bank- and lender-originated loans, not all non-federal loans. NPSAS is the only nationally representative, publicly available source of information on private loan borrowing. Unlike the NPSAS data related to federal loans and other aid, which the federal government collects from multiple sources including colleges and lenders, the private loan data relies on student self-reports. Even when the same private lender, such as Sallie Mae, makes both private and federal student loans, it is only required to report data on the terms and repayment status of its *federal* loans to the Department of Education. Colleges do not necessarily know when students take out private loans or collect information about the private loans they do know about. The limitations of available data on private loans mean they can only be used for aggregate estimates. They do not, for instance, shed light on important issues such as private loan borrowing patterns at specific colleges, or allow mandated entrance or exit counseling for federal loans to provide borrowers with information about their total student loan debt.

[3] Baum, Sandy and Patricia Steele. *Policy Brief: How Much Are College Students Borrowing?* The College Board. August 2009. http://professional.collegeboard.com/rofdownloans/cb-policy-brief-collge-stu-borrowing-aug-2009.pdf

exclude students who are not U.S. citizens or permanent residents and therefore ineligible for federal loans.[4]

Private student loans: more like credit cards than financial aid

Private student loans, sometimes called "alternative" student loans, are offered by a variety of banks and other lenders, and they can generate huge profits through high variable rates and fees. Some lenders that offer private loans also offer federal loans through the Federal Family Education Loan Program, which subsidizes private lenders to make loans on the government's terms and guarantees these loans against default. For example, Sallie Mae offers both federal Stafford loans and private "Smart Option" loans, both of which may appear on a student's financial aid award letter with the Sallie Mae brand. Such dual offerings can leave students, parents, and even sophisticated finance reporters confused about the difference. Many wrongly assume that the term "student loan" itself designates a safe form of financing.

Federal student loans are designed to help ensure broad access to affordable financing for higher education and training, and they are legitimately considered a form of financial aid. Borrowers can count on fixed, affordable interest rates, low fees, and important consumer protections, repayment options, and forgiveness programs backed by federal tax dollars. Examples include the new Income-Based Repayment plan described above, deferments during periods of unemployment and some types of public service, and the right to cancel outstanding debt if a borrower dies, is severely disabled, or attends a school that shuts down before they can finish their degree. Federal loan terms and conditions are set by Congress, and they are the same for all borrowers regardless of their income, credit score, or where they go to school.

Private student loans, on the other hand, are one of the riskiest ways to pay for a college education. They are not financial aid any more than a credit card is when used to pay for textbooks or tuition. Because of the high risks and costs associated with private loans, experts agree that students should always exhaust their federal loan options before even considering a private student loan

Private loans typically have variable interest rates that are higher for those who can least afford them. In 2008, interest rates for private loans were as high as 18 percent, based in part on the borrower's credit score. These variable rates are rarely capped and can change as often as once a month. Fees vary widely between lenders and even between borrowers with the same lender. Promissory notes usually give the loan holder broad

[4] From "Private Loans: Facts and Trends." The Project on Student Debt. Available online at http://projectonstudentdebt.org/files/pub/private_loan_facts_trends_09.pdf; Steele, Patricia and Sandy Baum. "How much are college students borrowing?" College Board Policy Brief. Available online at http://professionals.collegeboard.com/profdownload/cb-policy-brief-college-stu-borrowing-aug-2009.pdf

authority to increase borrower costs, such as raising interest rates in response to late payments.[5]

Because private loans do not carry the kinds of consumer protections that are guaranteed with federal loans, private loan borrowers are at the mercy of their lenders if they have trouble keeping up with punitively high payments, regardless of the reason. Even when lenders opt to offer a short-term forbearance, during which interest continues to accrue, lenders may charge borrowers additional fees for this costly form of temporary relief. Private loans are rarely cancelled even in cases of death or severe disability.[6] And while federal loans only go into default after nine months of delinquency, private lenders can declare default for almost any reason, such as a payment that is just one day late[7] or if you, "[i]n the lender's judgment, experience a significant lessening of your ability to repay the Loan[.]"[8]

Private loans and bankruptcy: a double standard for consumer debt

Despite their similarities to credit cards and other consumer debt, private loans are treated very differently under current bankruptcy law. Credit card debt and most other types of debt qualify for discharge when the borrower is approved for bankruptcy. In contrast, private student loans are treated like back taxes, child support, federal student loans and criminal fines, making them nearly impossible to discharge. Despite having already declared bankruptcy, consumers with private student loans must then initiate a separate legal proceeding, in which they have to prove to a judge that repayment of their private student loan debt would constitute an "undue hardship." As other witnesses will discuss in more detail, without a high-priced attorney, this is virtually impossible to do, and even then the outcome depends more on which judge is assigned to the case than on the borrower's situation.[9]

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[5] "2009 SLA Private Loan Series: Miss A Payment On Your Private Student Loan, You Could See Your Interest Rate Rise." Student Lending Analytics blog. April 21, 2009. Available online at http://studentlendinganalytics.typepad.com/student_lending_analytics/2009/04/2009-sla-private-loan-series-miss-a-payment-on-your-private-student-loan-you-could-see-your-interest.html

[6] Loonin, Deanne and Cohen, A. *Paying the Price: The High Cost of Private Student Loans and the Dangers for Student Borrowers.* National Consumer Law Center. March 2008. http://www.studentloanborrowerassistance.org/uploads/File/Report_PrivateLoans.pdf

[7] "2009 SLA Private Loan Series: The Promissory Note." Student Lending Analytics blog. April 20, 2009. Available online at http://studentlendinganalytics.typepad.com/student_lending_analytics/2009/04/2009-private-loan-series-the-promissory-note.html

[8] From the Student Loan Borrower Assistance webpage on "Default and Delinquency." Available online at http://www.studentloanborrowerassistance.org/default-and-delinquency/#private

[9] Pardo, Rafael I. and Lacey, Michelle R., "Undue Hardship in the Bankruptcy Courts: An Empirical Assessment of the Discharge of Educational Debt." *University of Cincinnati Law Review*, Vol. 74, No. 2, Winter 2005, pg. 7; Tulane Public Law Research Paper No. 05-06. Available at SSRN: http://ssrn.com/abstract=706761. See also Pardo and Lacey, "The Real Student-Loan Scandal: Undue Hardship Discharge Litigation" (October 24, 2008). *American Bankruptcy Law Journal*, Vol. 83, No. 1,

It is inappropriate and unfair both to borrowers and their other creditors to treat private student loans so differently from other comparable types of debt. The result is that private loan borrowers in dire financial straits can be condemned to a lifetime of collection agency harassment and ruined credit ratings simply because of the type of financing they used to help cover college costs. While many financial advisors will tell you that student loans are safer than credit cards, this is not necessarily the case for private student loans. At least if you put your tuition on a credit card, it would be dischargeable in bankruptcy should you ever reach unfortunate point of needing such relief.

It is important to note that personal bankruptcy is a very painful and costly process that people rarely undertake unless they have exhausted every other option. In 2005, the Bankruptcy Abuse Prevention and Consumer Protection Act made it much harder to qualify for personal bankruptcy

The 2005 law also made private student loans just as hard to discharge as federal student loans, despite the many important differences noted above. There are reasonable arguments for making federal loans at least somewhat harder to discharge than general consumer debt, if not necessarily as hard as criminal fines. For example, federal loans are backed by taxpayer dollars and offer some relief in situations of economic hardship, unemployment, death and disability, as well as payment plans that can help borrowers meet their obligations. In contrast, private student loans are not federally guaranteed and are not required to provide such borrower protections or affordable payment options.

The high, unpredictable costs and inflexible repayment terms of private student loans can increase borrowers' risk of falling behind on mortgage payments or other kinds of debt, or going without health coverage and other necessities, just to keep up with their private loans. Such choices can lead to insolvency and even to bankruptcy, where at least some other debts could be discharged. Giving private student loan creditors preferential treatment in bankruptcy also puts other legitimate creditors at a significant disadvantage.

Shielding private loans from bankruptcy means that unaffordable repayment demands can essentially extend forever, leaving even the most destitute borrowers with no way out. This may make lenders less cautious about issuing high-cost loans to people who may not be able to afford them, including students at schools with low completion and job placement rates. For example, Sallie Mae dramatically increased its "non-traditional" or subprime lending to students at such schools in the years immediately following the 2005 bankruptcy law. Sallie stopped making these loans in 2008 because

2009; 3rd Annual Conference on Empirical Legal Studies Paper. Available at SSRN: http://ssrn.com/abstract=1121226.

of high default rates, which continue to rise for those students who were saddled with these unaffordable loans.[10]

Ironically, private loan creditors remain fully eligible for the bankruptcy protection that their borrowers are now denied. Bankruptcy helps failed businesses discharge outstanding debt and make a fresh start regardless of the nature or merits of their product or business model, or the types of debt they carry.

Last year, The Education Resources Institute (TERI) declared bankruptcy with tens of millions of dollars in outstanding debt. TERI guaranteed private student loans for First Marblehead Corporation, which was a major player in the private loan market and a strong advocate for making private loan debt non-dischargeable for borrowers. First Marblehead rode the wave of securitizations that led to the current credit crunch, packaging private student loans from other lenders and selling them as investments. When these loans experienced higher than expected default rates, TERI went bankrupt and First Marblehead's stock tumbled. Apparently, bankruptcy has enabled TERI to reorganize, and reports of its impending recovery buoyed First Marblehead's stock last month.[11] Meanwhile, TERI's website includes this reminder for private loan borrowers:

> "The bankruptcy laws provide that, unlike other commercial debt, a loan guaranteed by TERI can not be discharged or forgiven in a bankruptcy proceeding unless the borrower proves that repayment of the loan will cause him/her undue hardship."[12]

Also in 2008, Education Finance Partners, which specialized in private student loans, declared bankruptcy and closed its doors. It no longer has a website. In 2009, My Rich Uncle, another private loan company, declared bankruptcy.

Private loan market trends: up, then down, but definitely not out

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[10] Sallie Mae reported that its "non-traditional" loan portfolio grew from $3.7 billion at the end of 2006 to $5.1 billion at the end of 2008, when it ceased originating new non-traditional loans because of high default rates, which available reports suggest may be nearly 50 percent this year. Sallie Mae defines these loans as "education loans made to certain borrowers that have or are expected to have a high default rate as a result of a number of factors, including having a lower tier credit rating, low program completion and graduation rates or, where the borrower is expected to graduate, a low expected income relative to the borrower's cost of attendance." From Sallie Mae's quarterly report to the Securities and Exchange Commission, Form 10-Q, for the quarter ending June 30, 2009.
http://www.salliemae.com/NR/rdonlyres/98EB09F8-712E-41E5-B14B-B694791574F9/11349/2QTR200910QBOW75039BOW006_BITS_N_1517.pdf

[11] Sposito, Sean. "Heavy trading of First Marblehead draws attention." Boston Globe. August 11, 2009. Available online at http://www.boston.com/business/articles/2009/08/11/first_marblehead_declines_to_comment_on_unusual_market_activity/

[12] From TERI's website, page entitled "TERI – Loan Center – Students & Parents – Managing Education Debt." Available online at http://www.teri.org/loan-center/students-parents/managing-education-debt.asp

Over the past decade, the private student loan market expanded dramatically along with the overall credit market, fueled by easy access to capital. As with subprime mortgages, lenders marketed private loans very aggressively and financed them primarily through securitization, maximizing short-term profits regardless of borrowers' actual ability to repay. There were no regulations to limit the dangers of private loans or to restrict the way they targeted young people with no borrowing experience. Prospective borrowers were not even entitled to clear information about actual terms and costs that would enable them to shop around before signing a promissory note. Private student loans remain largely unregulated, Congress included some basic disclosure requirements in the HEOA will go into effect early next year.

Private student loan volume began mounting well before the change in bankruptcy law: it increased eight-fold between 1997 and 2005, and it peaked at $19 billion in academic year 2006-07.[13] Student Lending Analytics, which monitors industry trends, projects that volume in 2009 will be $10-12 billion.[14] This drop parallels changes in the larger economy due to the credit crunch, which hit the private loan industry hard in the fall of 2008. While quite a few lenders left the market and private loans are now more likely to require a co-signer and a higher credit score than in recent years, private student loans are still available. Sallie Mae continues to make a third of its profits from private loans, and they along with Chase, Citibank and other major lenders offer and actively promote their private loan products.[15] As these lenders work to expand their market share, credit unions have entered the field and seek to position themselves as a source for more affordable private loans.[16]

In a particularly disturbing development, some large, for-profit colleges have begun making a lot of their own private loans directly to high-risk students.[17] For example, in a recent call with investors and analysts, Corinthian Colleges, Inc. said it plans to make

[13] From "Trends in Student Aid." College Board Trends in Higher Education Series. Available online at http://www.collegeboard.com/html/costs/aid/4_1_loans.html

[14] Ranzetta,Tim. HESC Symposium: Unlocking the Mysteries of Private Student Loans. Student Lending Analytics. September 2009. Powerpoint presentation available at http://studentlendinganalytics.typepad.com/student_lending_analytics/2009/09/hesc-symposium-sla-presentation-on-private-student-loans.html

[15] Saha-Bubna, Aparajita. Dow Jones Newswires. "Sallie Mae: Balance Sheet To Shrink As FFELP Loans Run Off." September 21, 2009. http://www.nasdaq.com/aspx/stock-market-news-story.aspx?storyid=200909161017dowjonesdjonline000490&title=sallie-maebalance-sheet-to-shrink-as-ffelp-loans-run-off

[16] See the Credit Union Student Choice web site at http://www.studentchoice.org/ for press releases and marketing content, such as, "Unlike for-profit lenders, credit unions exist only to serve the best interests of their members-not to maximize profit for shareholders. This allows credit unions to offer lower loan rates and fees than other, more traditional "private" lenders."

[17] Pope, Justin. "For-Profit Colleges' Increased Lending Prompts Concerns." The Associated Press. August 15, 2009. Available online at http://www.usatoday.com/news/education/2009-08-15-profit-college-lending_N.htm. Also see "Corinthian Colleges, Inc. F4Q09 (Qtr End 06/30/09) Earnings Call Transcript" at http://seekingalpha.com/article/158257-corinthian-colleges-inc-f4q09-qtr-end-06-30-09-earnings-call-transcript?source=bnet.

$130 million of such loans in the current fiscal year, on top of $120 million last fiscal year. They fully expect a shocking 56 to 58 percent of the borrowers to default. Yet they consider these loans good investments because they will increase enrollment and with it a profitable flow of federal grant and loan dollars that outweighs the planned writeoffs. Corinthian owns more than 80 colleges across the U.S. through its Everest brands.[18] According to the Associated Press, ITT Education Services, Inc. also expects to make $75 million in loans directly to its students this calendar year, and Career Education Corp. expects to reach $50 million.[19]

These are attempts to get around market corrections that have appropriately reduced access to subprime private loans for very high risk borrowers, and to justify prices for for-profit education and training programs that may exceed federal aid limits. As mentioned above, Sallie Mae has stopped lending to these types of schools because of similarly high default rates and other questionable practices. But whether the source is their own school or an outside lender, the students who are sold private loans they cannot afford are stuck with them even in bankruptcy, while the lenders are free to move on.

Who ends up with private student loans, and why

Nearly three million undergraduate students ended up borrowing a private student loan in 2007-08, representing 14 percent of all undergraduates. Fully one third (33%) of all students receiving a bachelor's degree in 2007-08 borrowed a private loan at some point before they graduated. What else do we know about these borrowers?

- The odds of taking a private loan are highest at for-profit colleges, where 42 percent used a private loan in 2008-08. Next come private nonprofit four-year schools at 25 percent, public four-year schools at 14 percent, and community colleges at four percent.[20]
- The majority of undergraduate private loan borrowers attend lower priced schools. Almost two thirds (63%) of undergraduates with private loans were at schools with tuition and fees of $10,000 or less.
- More than half (56%) of undergraduates with private loans are dependents age 23 or younger, and they borrow on average 45 percent more than their older counterparts.
- Seventeen percent of African-American undergraduates borrowed a private student loan in 2007-08, making them the most likely to borrow among all racial and ethnic groups. Their rate of private loan borrowing also rose the most steeply, quadrupling from 2003-04 to 2007-08.

[18] From Corinthian College's website. Available online at http://www.cci.edu/brands/everest
[19] Pope, Justin. Ibid.
[20] From "Private Loans: Facts and Trends." The Project on Student Debt. Available online at http://projectonstudentdebt.org/files/pub/private_loan_facts_trends_09.pdf

- Nearly two thirds (64%) of all the undergraduates who took a private loan in 2007-08 borrowed less than they could have in federal Stafford loans. Of these students:
    - More than one quarter (26%) had not used any Stafford loans that year, including 14 percent who had not filled out the Free Application for Federal Student Aid (FAFSA).
    - More than one third (38%) had a Stafford loan, but for less than the maximum amount.

Students and families should be able to count on their college financial aid office to provide impartial advice about loans and lenders, and many of them can. However, over the past few years, federal, state and independent investigations have exposed numerous conflicts of interest between student loan companies and universities or their employees, raising questions about the integrity of the advice they give students about loans. College officials received gifts, trips, stock options and other benefits from lenders, while some colleges agreed to recommend certain lenders in exchange for kickbacks on the loan proceeds. In other cases, lenders provided staffing or call centers for a campus, posing as college representatives while providing financial aid advice—including information about private loans—to students. Congress passed legislation in 2008 aimed at curbing such abuses, but that did nothing to help the unsuspecting students who were saddled with unnecessarily costly loans.

Here are some examples of how students have been steered towards private loans:

- Education Finance Partners, a private loan company, made an arrangement with the Pratt Institute in New York: it would give the college money for need-based grant aid if Pratt students took out at least $1 million in the company's high-interest private loans.[21] Pratt cancelled the deal after two years, Education Finance Partners declared bankruptcy late last year, but the students who borrowed unnecessarily costly loans at the college's recommendation do not have these options.

- An investigation by Iowa's attorney general found that Iowa Student Loan Liquidity Corp. (ISL), a non-profit student loan company, gave kickbacks to colleges for steering students to ISL's private loans and falsely advertised its private loans as the 'lowest cost' options available.[22] While ISL engaged in these practices, Iowa's average student loan debt became the highest in the country.[23]

[21] Glater, Jonathan. "New York Art College Canceled Deal with Lender After Learning of High Interest Rates." New York Times. May 1, 2007. Available online at http://www.nytimes.com/2007/05/01/us/01loans.html?_r=2&ref=education

[22] From "Iowa Finds Lender's Practices Hurt by Student Borrowers," *Inside Higher Ed*. Available online at http://www.insidehighered.com/news/2008/10/27/iowa

[23] From "Student Debt and the Class of 2007." The Project on Student Debt. Available online at http://projectonstudentdebt.org/files/pub/classof2007.pdf

- Silver State Helicopter ran unlicensed and unaccredited for-profit flight schools that charged up to $70,000 in tuition. The company directly facilitated large private loans for thousands of students over nine years, some of whom were suing the school for fraud when it went bankrupt in 2008. The school collected all the loan money up front, yet Silver State had less than $50,000 in assets and $10 million in debt when it abruptly shut down.[24]

- As discussed above, some for-profit colleges are aggressively expanding their own private lending to students who are at very high risk of default. Pushing these students to take on private loan debt they cannot repay can be devastating for the students in the long run, but quite profitable for the school/lender.

- Last year we found that nearly a quarter of all public two-year colleges had opted out of the federal loan program, which prevented any of their students from using federal student loans. Nearly a million students attend these colleges, and they are disproportionately students of color. While many of these colleges believe they are acting in students' best interest by discouraging them from borrowing, a few openly encourage their students to borrow private loans by referring them to lenders. While there have been no allegations of conflicts of interest, and private loan usage at community college is still low, community college students with private loans are less likely to have maximized their federal loans than students in other sectors.

In contrast, some colleges go out of their way to help students avoid or minimize private loans and maximize federal loans and other aid instead. Both public and private colleges, such as Barnard College, Colorado State University, Loyola in New Orleans, and Northern Michigan University, have policies requiring counseling or warning students about the risks and alternatives when they learn that a student has applied for a private loan.[25] This has led to measurable reductions in private loan usage. For example:

- In 2005-06, 98 students at Barnard College, a private nonprofit college in New York City (2,400 students), took out a total of $1,559,385 in private loans. In 2006-07 Barnard implemented a new policy that withheld certification until private loan applicants had spoken with a Barnard financial aid officer. This change resulted in nearly 60 percent of private loan applicants choosing to not

[24] Friess, Steve. "Helicopter School Closes, Leaving Students in Lurch." New York Times. February 13, 2008. Available online at http://www.nytimes.com/2008/02/13/us/13vegas.html

[25] The opportunity arises when students apply for "certified" private loans. Lenders will not issue the loan until the school confirms the student's enrollment, cost of attendance, and aid received. Students may also get "uncertified" private student loans, which require no contact between the lender and the school. In those cases, the school may never learn that the student applied for a private student loan.

take out a private loan, and it reduced the total amount of private loans by almost 75 percent, or approximately \$1.1 million.[26]

- At Colorado State University, a public institution in Fort Collins (24,000 students), financial aid officers contact approximately 20 percent of private loan applicants because they either have not filled out their FAFSA or have maximized their federal student loans. Half of the contacted applicants opt to pursue their federal borrowing options first.[27]

Conclusion

Until 2005, bankruptcy law appropriately treated private student loans like credit cards and other comparable forms of consumer debt. Since then, punitive treatment in bankruptcy, combined with the continued lack of access to affordable repayment plans or other consumer protections, has left private loan borrowers with virtually no options for managing this type of high-risk, high-cost consumer debt. Millions of Americans who sought to further their education should not face higher hurdles in bankruptcy than the lenders who saddled them with these unaffordable loans.

Thank you again for the opportunity to testify today. I would be glad to answer any questions.

[26] From "Bucking the Tide on Private Loans," *Inside Higher Ed*. Available online at: http://www.insidehighered.com//news/2007/07/16/barnard

[27] From "Colorado State Does Student Loans Right," *HigherEdWatch.org*. Available online at: http://www.newamerica.net/blogs/education_policy/2007-08/colorado_state

Mr. COHEN. Thank you, Ms. Asher. We appreciate your testimony.

I now have the august power, which I announced at the beginning, to declare a recess of this hearing at any time I please. And if you noticed, my two colleagues urged me to start the panel. They have left. I need now to vote.

The hearing is recessed.

[Recess.]

Mr. COHEN. With the august power that I have we are now back in session. Mr. Conyers, I think, will be here in a second and Mr. Franks will be maybe back hopefully soon; he has another hearing.

So we thank Ms. Asher for her testimony, and now we will recognize Mr. Rafael Pardo, who is a tenured member of the faculty at Seattle University School of Law—which does not have a football team—and where he went to in July of 2006. Prior to that he was an associate professor of Tulane Law School, 2003 to 2006, routinely teaches courses in bankruptcy and commercial law.

Most of his research is focused on the discharge of student loans in bankruptcy and he has been published in the American Bankruptcy Law Journal, the Florida State University Law Review, and the University of Cincinnati Law Review. Before entering academia, he worked as an associate in the Business Reorganization and Restructuring Group of Willkie Farr & Gallagher in New York.

With that, we welcome Professor Pardo, and you may begin your testimony.

TESTIMONY OF RAFAEL I. PARDO, SEATTLE UNIVERSITY SCHOOL OF LAW

Mr. PARDO. Chairman Cohen, Ranking Member Franks, Chairman Conyers, and other Members of the Subcommittee, it is my great privilege and honor to testify today on the discharge of student loans in bankruptcy. Much of my academic research studies this process, and with each study I have conducted I have become increasingly convinced that the process is horribly broken and in desperate need of reform.

I want to begin today by providing some historical perspective on the treatment of educational debt in bankruptcy. That perspective underscores that we have reached the point where we are today as a result of interest group-driven legislation rather than sound policy choices.

Currently, a debtor may discharge student loans in bankruptcy only upon establishing that repaying such loans would impose an undue hardship, but this has not always been the case. Prior to 1977, student loans were automatically discharged in bankruptcy.

Perceived abuse of the bankruptcy system, as opposed to any real abuse, drove Congress to change this state of affairs. A 1976 GAO report had found that less than 1 percent of all federally insured and guaranteed educational loans were discharged in bankruptcy. In other words, no abuse.

What did exist at the time were isolated instances of bankruptcy filings by recent graduates on the eve of lucrative careers. These stories were sensationalized by student loan industry advocates and used to prompt Congress into legislating against alleged widespread abuse that did not exist. Simply put, a few bad apples spoiled the barrel rotten for everyone.

Over the past 3 decades, Congress has repeatedly curtailed the bankruptcy relief available to student loan debtors. In every instance that it has done so, there has never been, to my knowledge, any empirical evidence presented to demonstrate either real threats to the fiscal solvency of student loan programs or abuse of the bankruptcy system by student loan debtors.

The most recent change occurred with the 2005 amendments to the Bankruptcy Code. By virtue of that legislation, for-profit student loan lenders have been extended the special treatment that had been reserved, up to that point in time, for governmental and nonprofit student loan lenders.

This change did not meet with any objections from lawmakers, even from the House Members who expressed dissenting views to accompany the House Judiciary Committee's report on the 2005 amendments. This episode strikes me as one of the most emblematic instances of the student loan lobby's excessive influence on the design of the Bankruptcy Code's student loan discharge provision.

The upshot of the historical record is that the plight of bankruptcy debtors who seek a discharge of their student loans has become worse, and this has occurred without legitimate justification. I am, therefore, greatly encouraged that the Subcommittee is reexamining whether to undo the special treatment that exists in bankruptcy for private student loan lenders.

In the written testimony I have submitted to the Subcommittee, I make four major points. First, empirical evidence suggests that student loan debtors suffer from severe financial distress, more so than debtors in the general bankruptcy population.

In one of my studies, I found that the median debtor who sought a discharge of student loans was 42 years old and would have had to devote 2 years and 9 months of household income to fully repay those loans—assuming, during this period of time, that the debtor's household could live expense-free and that the educational debt would not balloon by virtue of interest, fees, and the like. This is a crushing debt burden, plain and simple.

Second, the undue hardship standard for discharging educational debt is currently undefined by the Bankruptcy Code. As such, the standard provides minimal guidance to litigants and judges. My studies have shown that this produces differential treatment of similarly situated debtors, with some granted a discharge and others denied a discharge.

Third, one of my studies demonstrates that legally-irrelevant factors, such as the level of experience of the debtor's attorney and the identity of the judge assigned to the debtor's case, seemingly affect whether a debtor obtains a discharge of his or her student loans. This raises important access to justice concerns.

Fourth, private student loans are largely unregulated. Borrowers of such loans often find themselves deeply mired in debt with limited options for repayment relief. When Congress removed the automatically dischargeable status of private student loans in bankruptcy it stripped away the social safety net available to borrowers of such loans. In the absence of robust non-bankruptcy relief from private student loans, the negative effects of litigating claims of undue hardship will fall disproportionately on debtors with such loans.

In terms of solutions, I respectfully urge Congress to restrike the balance between student loan debtors and lenders of private student loans by making such loans once again automatically dischargeable in bankruptcy. I would also urge Congress to clarify the undue hardship standard.

The simple solution would be to create a statutory presumption of undue hardship when a debtor does not have enough disposable income to make his or her student loan payments. An analogous presumption already exists as part of the process for approving reaffirmation agreements in bankruptcy. Writing a similar presumption into the Bankruptcy Code's undue hardship discharge provision would strike a more appropriate balance in a litigation process that unjustifiably favors student loan creditors, who undoubtedly have more resources than their debtor adversaries and who have more familiarity with the bankruptcy system as repeat players.

These proposed solutions are important first steps to restoring consistency in our higher education finance system, which currently has a public-oriented approach to student loan origination but a business-oriented approach to student loan collection.

This concludes my testimony. Thank you again for providing me the opportunity to testify before you today. I look forward to answering your questions.

[The prepared statement of Mr. Pardo follows:]

PREPARED STATEMENT OF RAFAEL I. PARDO

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Written Testimony
of

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Before the
United States House of Representatives
Committee on the Judiciary
Subcommittee on Commercial and Administrative Law

Hearing on
"An Undue Hardship? Discharging
Educational Debt in Bankruptcy"

September 23, 2009

Witness Background

I am currently a tenured member of the faculty at Seattle University School of Law, which I joined in July 2006. Prior to that, I was an associate professor at Tulane Law School from July 2003 through June 2006. Since entering academia, I have routinely taught courses in bankruptcy and commercial law. Most of my empirical research has focused on the discharge of student loans in bankruptcy and has been published in the *American Bankruptcy Law Journal*, the *Florida State University Law Review*, and the *University of Cincinnati Law Review*.[1]

Prior to entering academia, I worked as an associate in the Business Reorganization and Restructuring Group of Willkie Farr & Gallagher LLP in New York. I also served as a law clerk to the Honorable Prudence Carter Beatty of the United States Bankruptcy Court for the Southern District of New York. I received my J.D. degree from the New York University School of Law, where I served as an executive editor of the *New York University Law Review* and was a recipient of the Judge John J. Galgay Fellowship in Bankruptcy and Reorganization Law. I received my B.A. degree from Yale College.

I currently sit on the board of trustees of the Consumer Education and Training Services (CENTS), a nonprofit organization dedicated to providing a variety of resources to the Seattle community on matters of money management, consumer credit personal finances, and financial literacy. I also serve as a volunteer attorney for the King County Bar Association Debt Clinic. On January 1, 2010, I will begin a three-year term as an academic member of the Editorial Advisory Board of the *American Bankruptcy Law Journal*, a peer-reviewed journal that is published by the National Conference of Bankruptcy Judges. In 2005, I was selected as an American Bankruptcy Law Journal Fellow by the National Conference of Bankruptcy Judges; and in 2008, I was selected as an Institute for Higher Education Law and Governance Fellow in connection with the Houston Higher Education Finance Roundtable at the University of Houston Law Center.

I have not received any federal grants or any compensation in connection with this testimony. I also do not represent any party in connection with student loan issues (both inside and outside of bankruptcy). The views expressed in this written testimony are mine and do not necessarily reflect the views of Seattle University School of Law.

Introduction

Chairman Cohen, Ranking Member Franks, and Members of the Subcommittee:

I am pleased to testify in support of any legislation that would restore the unconditionally dischargeable status of private student loans in bankruptcy that existed prior to the enactment of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA).[2] As student-loan defaults and bankruptcy filings continue to rise in the current economic downturn,[3] more student-loan borrowers will inevitably find themselves within the bankruptcy system seeking forgiveness of their debt. Unfortunately, many of them, including some who are among the most desperate for relief, are unlikely to get the fresh start that the bankruptcy system promises other types of individual debtors.

The general rule in bankruptcy is that all prebankruptcy debts are discharged—that is, a debtor will no longer be personally liable for such debts after emerging from bankruptcy. This represents bankruptcy's fresh start for debtors. The Bankruptcy Code, however, singles out certain types of debts as nondischargeable (e.g., debts for certain income taxes; debts for alimony, maintenance, and child support). Debts for student loans are exceptional insofar as they are the only type of debt that is *conditionally* dischargeable in bankruptcy—that is, the debt is not automatically discharged but can be upon the satisfaction of a certain condition. If a debtor establishes that repayment of the student-loan debt would impose an undue hardship, the debt will be discharged.[4] Accordingly, the Bankruptcy Code requires a court to determine whether a debtor's circumstances warrant forgiveness of such debt.

There are two issues that are of particular concern with the process for discharging student loans in bankruptcy. First, the discharge standard for student loans, undue hardship, is undefined by the Bankruptcy Code. Because it is a vague and indeterminate standard, concerns arise that similarly situated debtors will obtain differential treatment given the inherent subjectivity of the standard. Second, for a debtor to obtain a discharge of student loans, the debtor must initiate an adversary proceeding against the creditor—essentially, a full-blown law suit. Because bringing such a proceeding requires substantial monetary resources, debtors in bankruptcy, already in financial distress, face additional hurdles in obtaining a discharge of their student loans.

My most recent co-authored study on this topic documents and analyzes trial-level outcomes of adversary proceedings in bankruptcy pursuant to which debtors have sought to discharge their student loans.[5] The goal of the study was to ascertain whether evidence exists suggesting that it is problematic that the current bankruptcy system necessitates litigation as the path to relief from educational debt. My co-author (Professor Michelle R. Lacey from Tulane University) and I conclude that such evidence does exist and that there are important access-to-justice concerns for student-loan debtors. Ultimately, our findings challenge long-standing assumptions regarding the propriety of discharge litigation for relief from student loans in a bankruptcy system that is designed to provide debtors a fresh start.

My written testimony makes the following major points:

1) Empirical evidence suggests that student-loan debtors who seek a discharge of educational debt in bankruptcy suffer from severe financial distress.

2) The legal standard for discharging educational debt in bankruptcy, undue hardship, is currently undefined by the Bankruptcy Code. As such, the standard provides minimal guidance to litigants and judges. This produces differential treatment of similarly situated debtors, with some granted a discharge and others denied a discharge.

3) Legally irrelevant factors that should not bear on the merits of a debtor's claim for relief, such as the level of experience of the debtor's attorney and the identity of the judge assigned to the debtor's case, appear to affect whether a debtor obtains a discharge of his or her student loans. Accordingly, the procedural hurdles that student-loan debtors confront in litigating their claims of undue hardship further exacerbate the problem of inconsistent outcomes.

4) Private student loans are largely unregulated. Without limits on the amount that students can borrow, with limited options for repayment relief, and with variable interest rates, borrowers of such loans often find themselves deeply mired in debt.[6] In 2005, when Congress removed the unconditionally dischargeable status of such loans in bankruptcy, it stripped away the social safety net available to the borrowers of such loans. In the absence of robust nonbankruptcy relief from private student loans, it stands to reason that the negative effects of litigating claims of undue hardship will fall disproportionately on debtors with such loans.

The remainder of my testimony will elaborate on these four points. It will conclude by suggesting that Congress should amend the Bankruptcy

Code (1) to make private student loans automatically dischargeable and (2) to clarify the undue hardship standard.

Debtors Who Seek an Undue Hardship Discharge of Their Student-Loans Likely Suffer from Severe Financial Distress

The following financial portrait of student-loan debtors who seek an undue hardship discharge is derived from my co-authored study that was published in 2009 (the "Discharge Litigation Study").[7] That study focused on the litigation of undue hardship adversary proceedings that were commenced in the U.S. Bankruptcy Court for the Western District of Washington during the five-year period spanning 2002 through 2006.[8] Because the data are confined to the experience of litigants in a single federal judicial district during a half-decade period, it cannot be said that the data are representative of undue hardship discharge litigation nationally, including the profile of debtors who seek such a discharge. That said, the Western District of Washington appears to be comparable to the nation in terms of (1) the consumer bankruptcy filing rate, (2) the level of educational attainment of the adult population, and (3) levels of student-loan debt.[9] Furthermore, regardless of whether the data are nationally representative, they shed light on the profile of certain student-loan debtors who have looked to the bankruptcy system for relief from their educational debt.

The median student-loan debtor in the Discharge Litigation Study suffered from severe financial distress. Consider the following statistics, keeping in mind that all dollar amounts from the study have been converted to 2009 dollars for purposes of this written testimony. The annual income generated by the median debtor's household was $19,188. Once taking into account the annual expenses of the median debtor's household, *exclusive* of any expenses relating to the debtor's student loans, the annual disposable income of the median debtor's household was an annual deficit of $2,064 (i.e., -$2,064). In other words, the median debtor household lacked excess income to repay the debtor's student loans, which for the median debtor amounted to $56,711.

One can get a better sense of the crushing student-loan burden faced by the median debtor in the Discharge Litigation Study by focusing on the ratio of student-loan debt to annual household income—a measure that indicates the number of years of household income the debtor would have to dedicate to fully repay his or her student loans, assuming that the debtor's household during this period of time would live expense free and that the educational debt would not increase by virtue of accrued interest, fees, and the like. When calculating this educational debt-to-income ratio on a debtor-by-debtor basis, the median debtor in the Discharge Litigation Study would have had to devote two years and nine months of household income to fully repay his or her student loans. In comparison, consider that the median debtor in the general bankruptcy population in 2007 would have had to devote approximately one year and three months of income to fully repay his or her total unsecured debt.[10]

Clearly, many of the debtors in the Discharge Litigation Study faced severe financial distress as a result of their educational debt.[11] Before addressing how the debtors in the study fared in litigating their claims of undue hardship, this testimony will summarize how bankruptcy court doctrine (i.e., published and unpublished opinions issued by bankruptcy courts in connection with student-loan discharge determinations) has interpreted and applied the undue hardship standard.

The Inconsistency of the Undue Hardship Doctrine

The Bankruptcy Code provides that educational debt may not be discharged "unless excepting such debt from discharge . . . would impose an undue hardship on the debtor and the debtor's dependents."[12] Because the Code does not define undue hardship, courts have had to establish a framework for analyzing a debtor's claim of undue hardship. The dominant framework, established by the U.S. Court of Appeals for the Second Circuit in *Brunner v. New York State Higher Education Services Corp.*,[13] requires a debtor to show:

> (1) that the debtor cannot maintain, based on current income and expenses, a "minimal" standard of living for herself and her dependents if forced to repay the loans; (2) that additional circumstances exist indicating that this state of affairs is likely to persist for a significant portion of the repayment period of the student loans; and (3) that the debtor has made good faith efforts to repay the loans.[14]

This test has been endorsed and adopted by eight other federal courts of appeals.[15]

In 2005, Professor Lacey and I empirically investigated the manner in which bankruptcy courts have applied the undue hardship doctrine.[16] We examined ten years' worth of opinions issued by bankruptcy courts in undue hardship discharge determinations.[17] In that study, we expected to find statistically significant differences in the demographic and financial characteristics of debtors who were granted a discharge and debtors who were denied a discharge—after all, it is the factual circumstances of a debtor's claim of undue hardship that ought to give content to the law. Contrary to our expectation, however, we found few statistically significant differences between the two groups of debtors.[18] We concluded that legal outcome was best explained by differing judicial perceptions of how the same standard applied to similarly situated debtors.[19] In other words, bankruptcy court doctrine had generally been inconsistent in its treatment of student-loan debtors.

In a follow-up study,[20] I found that, where the doctrine had been applied consistently, the measure of consistency turned on whether the debtor suffered from a medical condition.[21] After showing how a debtor's health can be an underinclusive metric for gauging a debtor's inability to repay his or her student loans, I concluded that bankruptcy court doctrine had failed to give the undue hardship standard its proper reach—that is, providing relief to student-loan debtors with an inability to repay their educational debt.[22]

The findings from both of these studies raise several concerns. If one conceives of the bankruptcy court doctrine as serving a signaling function to litigants regarding the likelihood of relief for the debtor, and if that doctrine is generally unclear, it seems more likely that litigants will not have overlapping expectations regarding the outcome of undue hardship discharge proceedings. This, in turn, will discourage settlement,[23] thus requiring litigants to incur more litigation costs—which would, on balance, have a disproportionate impact on debtors who file for bankruptcy as a result of financial distress and a lack of monetary resources.[24] Moreover, if the doctrine signals to litigants that suffering from a medical condition is a necessary element for establishing a claim of undue hardship, then the doctrine will likely discourage some healthy debtors with meritorious claims of undue hardship from pursuing a discharge of their educational debt. It is against this doctrinal backdrop that the debtors in the Discharge Litigation Study litigated their claims of undue hardship.

The Negative Effects of Undue Hardship Discharge Litigation

In terms of substantive outcome, the discharge of student loans appears to be the rule rather than the exception in the Western District of Washington: Approximately 57% of the adversary proceedings in the Discharge Litigation Study resulted in some amount of debt discharged (whether through settlement or through trial), with the median debtor obtaining a discharge of approximately 71% of his or her educational debt.[25] At first blush, it appears that the debtors in the study experienced a moderate rate of success. Further considerations, however, suggest that Congress ought to be concerned about the manner in which litigating a claim of undue hardship may encroach upon a student-loan debtor's fresh start.

First, it should be noted that the U.S. Court of Appeals for the Ninth Circuit has held that a court may grant a debtor a partial undue hardship discharge, provided that the debtor satisfies the burden of proof with respect to the portion of the educational debt that imposes an undue hardship.[26] Accordingly, courts within the Ninth Circuit, including the U.S. Bankruptcy Court for the Western District of Washington, have flexibility in fashioning relief for student-loan debtors, whereas courts in other regions of the nation have worked within the confines of the undue hardship discharge as an all-or-nothing proposition.[27] If applicable legal standards require a showing of undue hardship with respect to all of a debtor's educational debt, it seems reasonable to conclude that such a requirement imposes a higher evidentiary hurdle that reduces the likelihood of prevailing on a claim of undue hardship. The possibility therefore exists that student-loan debtors in other parts of the country do not fare as well as their counterparts in the Western District of Washington.

Second, the Discharge Litigation Study sought to identify the factual characteristics surrounding a debtor's undue hardship claim that were statistically significantly associated with the extent to which the debtor's student loans were discharged. The study considered factual characteristics that the legal doctrine would deem relevant (e.g., the debtor's age, health status, and employment status) and irrelevant (e.g., the experience level of the debtor's attorney, the identity of the judge assigned to the debtor's adversary proceeding) to the merits of the debtor's claim. The disquieting revelations of the study were (1) that legally irrelevant characteristics were associated with legal outcome and (2) that those characteristics were more strongly associated with legal outcome than the handful of legally relevant characteristics associated with legal outcome.[28] Professor Lacey and I concluded that, "[i]f extralegal factors predominantly influence the extent of discharge obtained by student-loan debtors, then policymakers need to reconsider the assumptions they have made regarding the propriety of discharge litigation in a system oriented toward granting substantive relief to debtors."[29]

The Disproportionate Impact of Undue Hardship Discharge Litigation on Debtors with Private Student Loans

In recent years, private student loans have increasingly grown as a source of funding for students' higher education costs.[30] The increased reliance on private student loans can be attributed to the effort of borrowers and their families to close the gap between education costs and other available sources of funding—a gap that has widened as a result of (1) rising tuition rates that have outpaced the rate of inflation, (2) limited amounts of federal aid and scholarship aid, (3) stagnant incomes, and (4) reduced savings (including the disappearance of home equity against which families can borrow).[31] Due to the absence of other options for pursuing the promise of higher education, borrowers of private student loans unfortunately end up facing higher risks than do borrowers of federal student loans:

> With private loans, options for handling overwhelming debt burden are more limited in comparison to federal loans, and lenders are not mandated to offer any particular relief. . . . Understanding the impact of the availability of economic hardship relief is particularly important for students with the lowest incomes or independent students paying for their own college expenses, a group to which the private loan industry is increasingly reaching out.[32]

In more blunt terms, New York State Attorney General Andrew M. Cuomo has referred to private student loans as the "Wild West of the student loan industry."[33]

Because the costs of private student loans can quickly spiral out of control, and because there exist limited nonbankruptcy options for mitigating the financial distress imposed by such costs, borrowers of private student loans are particularly vulnerable to the negative effects of undue hardship discharge litigation. If they end up seeking relief through the bankruptcy system and subsequently fail to prevail in their claim of undue hardship, they will find themselves struggling interminably under an oppressive amount of educational debt with little to no other options for relief. By stripping away the one social safety net that existed for borrowers of private student loans—that is, the automatic discharge of such loans in bankruptcy—Congress has likely condemned certain student-loan debtors to the Sisyphean task of repaying obligations that will never be extinguished.

Proposed Solutions

In light of my foregoing testimony, I respectfully urge Congress to restrike the balance between student-loan debtors and lenders of private student loans by restoring the automatically dischargeable status of private student loans in bankruptcy. Doing so would provide borrowers of such loans with a much needed social safety net.

Critics of such a proposal are likely to respond that making private student loans automatically dischargeable in bankruptcy will have the negative effects of (1) decreasing the availability of private student loans due to the increased availability of the discharge of such loans and (2) encouraging abuse of the bankruptcy system by borrowers of such loans. In response to the former point, existing empirical research indicates that, subsequent to BAPCPA's enactment and the reduced availability of the discharge of private student loans, the availability of such loans increased only slightly and only for borrowers with the lowest credit scores.[34] In other words, economic theory aside, the market for private student loans appears to be predominantly insensitive to the risk of bankruptcy discharge.

In response to the latter point, first and foremost, the pecuniary and nonpecuniary costs associated with a bankruptcy filing likely prompt debtors to view bankruptcy relief as an option to be exercised only in the most dire of circumstances rather than an easy fix to their financial distress.[35] Moreover, the Bankruptcy Code provides independent mechanisms for a court to police abuse of the bankruptcy system by student-loan debtors. If a student-loan debtor files for Chapter 7 relief in bad faith, this provides a basis for the court to dismiss the debtor's case;[36] and if a student-loan debtor files for Chapter 13 relief in bad faith, this too provides a basis for the court to dismiss the debtor's case.[37] Accordingly, criticisms of making private student loans automatically dischargeable in bankruptcy are likely to be unfounded and should therefore fall on deaf ears.

I would also urge Congress to clarify the undue hardship standard. Here, there is a simple solution that would bring certainty to the standard while simultaneously harmonizing the Bankruptcy Code. The Code currently provides that, if a debtor seeks to enter into an agreement with a creditor that would make the debtor legally bound to repay a debt that otherwise would have been discharged, such a reaffirmation agreement will be enforceable only if, among other requirements, the "agreement does not impose an undue hardship on the debtor or a dependent of the debtor."[38] With the 2005 amendments to the Bankruptcy Code, Congress provided that a presumption of undue hardship arises in the context of reaffirmation agreements if the debtor's disposable income (i.e., income less expenses) is insufficient to make the payments specified in the reaffirmation agreement.[39] The debtor may rebut the presumption, thereby clearing the way for approval of the agreement, only by identifying an additional source of funds that will enable the debtor to make the scheduled payments.[40]

One witnesses in the reaffirmation context the formulation of undue hardship as a function of presuming that a debtor will have a future inability to repay a debt based on the debtor's current inability to repay. Were Congress to write a similar presumption into the Bankruptcy Code's undue hardship discharge provision, it would relieve debtors from the unreasonable burden that current doctrine has imposed upon them—namely, the requirement to forecast with certainty a future inability to repay that will persist over a significant period of time, a period that can potentially span decades given the long repayment periods for certain student loans.[41] Instead, student-loan creditors would bear the burden of rebutting the presumption of the debtor's inability to repay. This legislative change would strike a more appropriate balance in a litigation process that unjustifiably favors of creditors:

> Debtors who have filed for bankruptcy in the first instance as a result of financial distress must somehow find the resources to litigate a full-blown lawsuit in order to prove that their predicament qualifies them for relief from their student loans. It does not take much imagination to recognize that a power imbalance exists in this context tilting in favor of student-loan creditors who undoubtedly have more resources and, as repeat players, more familiarity with the system. Thus, the structure of the system threatens access to justice by debtors with the concomitant effect of undermining the fresh start policy in bankruptcy.[42]

Finally, incorporating such a presumption would bring a consistent meaning to the phrase "undue hardship" throughout the Bankruptcy Code.

Conclusion

The House of Representatives recently signaled its commitment to the plight of student-loan borrowers by passing the Student Aid and Fiscal Responsibility Act of 2009,[43] which would expand federal aid to college students. For that commitment to be fully realized, however, this chamber must be equally responsive to the plight of student-loan debtors who seek bankruptcy relief from their educational debt. To do otherwise is to allow our higher education finance system to be plagued by inconsistent policies—that is, "a public-oriented approach to student-loan origination but a business-oriented approach to student-loan collection."[44] It is my hope that Congress will enact legislation similar to that which I have proposed in my testimony, and I stand ready to assist the Subcommittee in any way that I can to make that hope become reality.

Thank you for considering my views.

Rafael I. Pardo
Associate Professor of Law

[1] Rafael I. Pardo & Michelle R. Lacey, *The Real Student-Loan Scandal: Undue Hardship Discharge Litigation*, 83 AM. BANKR. L.J. 179 (2009) [hereinafter Pardo & Lacey, *Undue Hardship Discharge Litigation*]; Rafael I. Pardo, *Illness and Inability to Repay: The Role of Debtor Health in the Discharge of Educational Debt*, 35 FLA. ST. U. L. REV. 505 (2008); Rafael I. Pardo & Michelle R. Lacey, *Undue Hardship in the Bankruptcy Courts: An Empirical Assessment of the Discharge of Educational Debt*, 74 U. CIN. L. REV. 405 (2005) [hereinafter Pardo & Lacey, *Undue Hardship in the Bankruptcy Courts*]. These articles are available at http://ssrn.com/author=355713.

[2] In using the phrase "private student loan," I am specifically referring to an "educational loan that is a qualified education loan, as defined in section 221(d)(1) of the Internal Revenue Code of 1986, incurred by a debtor who is an individual." 11 U.S.C. § 523(a)(8)(B) (2006). Congress amended the Bankruptcy Code in 2005 to include such loans among the types of educational debt that can discharged only upon a showing of undue hardship. Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, § 220, 119 Stat. 23, 59 (codified at 11 U.S.C. § 523(a)(8)(B)). Prior to 2005, such debts were automatically dischargeable in bankruptcy. *See* 11 U.S.C. § 523(a)(8) (2000) (amended 2005).

[3] *See, e.g.*, Tara Siegel Bernard & Jenny Anderson, *Downturn Drags More Consumers into Bankruptcy*, N.Y. TIMES, Nov. 16, 2008, at A1; Anne Marie Chaker, *Student Loans: Default Rates Are Soaring*, WALL. ST. J., Apr. 21, 2009, at D1; Tamar Lewin, *Student Loan Default Rate Rises*, N.Y. TIMES, Sept. 15, 2009, at A14.

[4] 11 U.S.C. § 523(a)(8) (2006).

[5] *See* Pardo & Lacey, *Undue Hardship Discharge Litigation*, *supra* note 1.

[6] *See* Sandra Block, *Private Student Loans Pose Greater Risk*, USA TODAY, Oct. 25, 2006, at 1B; Diana Jean Schemo, *With Few Limits and High Rates, Private Loans Deepen Student-Debt Crisis*, N.Y. TIMES, June 10, 2007, at A28.

[7] *See* Pardo & Lacey, *Undue Hardship Discharge Litigation*, *supra* note 1. For additional data documenting the financial characteristics of student-loan debtors who have sought an undue hardship discharge of their educational debt, see Pardo & Lacey, *Undue Hardship in the Bankruptcy Courts*, *supra* note 1, at 452-76.

[8] For a description of how the data for the study were obtained, see Pardo & Lacey, *Undue Hardship Discharge Litigation*, *supra* note 1, at 202-03.

[9] *See id.* at 200-02.

[10] *See* Robert M. Lawless et al., *Did Consumer Bankruptcy Reform Fail? An Empirical Study of Consumer Debtors*, 82 AM. BANKR. L.J. 349, 373 (2008) (reporting median unsecured debt-to-income ratio of 1.22 for debtors who filed for bankruptcy in 2007).

[11] For further details regarding the financial profile of the debtors in the Discharge Litigation Study, see Pardo & Lacey, *Undue Hardship Discharge Litigation*, *supra* note 1, at 206-08.

[12] 11 U.S.C. § 523(a)(8) (2006).

[13] 831 F.2d 395 (2d Cir. 1987) (per curiam).

[14] *Id.* at 396.

[15] *See* Educ. Credit Mgmt. Corp. v. Frushour (*In re* Frushour), 433 F.3d 393, 400 (4th Cir. 2005); Oyler v. Educ. Credit Mgmt. Corp. (*In re* Oyler), 397 F.3d 382, 385 (6th Cir. 2005); Educ. Credit Mgmt. Corp. v. Polleys, 356 F.3d 1302, 1309 (10th Cir. 2004); U.S. Dep't of Educ. v. Gerhardt (*In re* Gerhardt), 348 F.3d 89, 91 (5th Cir. 2003); Hemar Ins. Corp. of Am. v. Cox (*In re* Cox), 338 F.3d 1238, 1241 (11th Cir. 2003); United Student Aid Funds, Inc. v. Pena (*In re* Pena), 155 F.3d 1108, 1112 (9th Cir. 1998); Pa. Higher Educ. Assistance Agency v. Faish (*In re* Faish), 72 F.3d 298, 306 (3d Cir. 1995); *In re* Roberson, 999 F.2d 1132, 1135 (7th Cir. 1993). Other courts have adopted a "totality of the circumstances" test, including the U.S. Court of Appeals for the Eight Circuit. *See* Long v. Educ. Credit Mgmt. Corp. (*In re* Long), 322 F.3d 549, 553 (8th Cir. 2003).

[16] Pardo & Lacey, *Undue Hardship in the Bankruptcy Courts*, *supra* note 1.

[17] *See id.* at 433-38.

[18] *See id.* at 481-86.

[19] *See id.* at 495-509.

[20] *See* Pardo, *supra* note 1.

[21] *See id.* at 509-13.

[22] *See id.* at 516-24.

[23] In the Discharge Litigation Study, 18% of the undue hardship adversary proceedings went to trial. Pardo & Lacey, *Undue Hardship Discharge Litigation*, *supra* note 1, at 210. This trial rate starkly contrasts with the trial rate that has been documented for all adversary proceedings in bankruptcy, which Elizabeth Warren has found to be in steady decline: While 16% of all adversary proceedings in the nation went to trial in 1985, the percentage dropped to 5% by 2002. *See* Elizabeth Warren, *Vanishing Trials: The New Age of American Law*, 79 AM. BANKR. L.J. 915, 930 (2005). In discussing the difference in these trial rates, Professor Lacey and I have observed the following:

> The high trial rate [for undue hardship adversary proceedings] has the potential to be problematic. It has been suggested that the diminishing trial rate in bankruptcy adversary proceedings can be attributed to the evolving certainty in decisional standards, which has better enabled parties to agree on expected outcomes and thus reach settlement with greater frequency. We have already noted that the undue hardship standard appears to be far from certain. Perhaps this accounts for the high trial rate for undue hardship discharge adversary proceedings relative to adversary proceedings generally. If so, then it becomes imperative that the standard be clarified, particularly because of the adverse impact that such uncertainty is likely to have upon a debtor's fresh start.

Pardo & Lacey, *Undue Hardship Discharge Litigation*, *supra* note 1, at 210-11 (footnotes omitted).

[24] For further discussion of this litigation dynamic, see Pardo & Lacey, *Undue Hardship Discharge Litigation*, *supra* note 1, at 190-92.

[25] *Id.* at 213.

[26] Saxman v. Educ. Credit Mgmt. Corp. (*In re* Saxman), 325 F.3d 1168, 1175 (9th Cir. 2003).

[27] *See, e.g.*, Pincus v. Graduate Loan Ctr. (*In re* Pincus), 280 B.R. 303, 311-12 (Bankr. S.D.N.Y. 2002).

[28] *See* Pardo & Lacey, *Undue Hardship Discharge Litigation*, *supra* note 1, at 223-29.

[29] *Id.* at 235.

[30] INST. FOR HIGHER EDUC. POLICY, THE FUTURE OF PRIVATE LOANS: WHO IS BORROWING, AND WHY? 1 (2006); Block, *supra* note 6; Schemo, *supra* note 6.

[31] *See* INST. FOR HIGHER EDUC. POLICY, *supra* note 30, at 13; Jonathan D. Glater, *College Costs Outpace Inflation Rate*, N.Y. TIMES, Oct. 23, 2007, at A23; Jonathan D. Glater, *Fewer Options for Paying Costs of College*, N.Y. TIMES, Apr. 12, 2008, at A1; Jonathan D. Glater, *In a Downturn, College Strains Family Budgets*, N.Y. TIMES, Oct. 17, 2008, at A1; Jonathan D. Glater, *Scholarships for College Dwindle as Providers Pull Back Their Support*, N.Y. TIMES, June 27, 2009, at A8; Tamar Lewin, *Higher Education May Soon Be Unaffordable for Most Americans, Report Says*, N.Y. TIMES, Dec. 3, 2008, at A19.

[32] INST. FOR HIGHER EDUC. POLICY, *supra* note 30, at 11.

[33] *Paying for College: The Role of Private Student Lending*, Hearing Before the S. Comm. on Banking, Housing, and Urban Affairs, 110th Cong. (June 6, 2007) (written testimony of Andrew M. Cuomo, State of N.Y. Att'y Gen., at 3), *available at* http://banking.senate.gov/public/_files/cuomo.pdf.

[34] *See* MARK KANTROWITZ, FINAID.ORG, IMPACT OF THE BANKRUPTCY EXCEPTION FOR PRIVATE STUDENT LOANS ON PRIVATE STUDENT LOAN AVAILABILITY (2007), *available at* http://www.finaid.org/educators/20070814pslFICOdistribution.pdf

[35] In terms of pecuniary costs, future extensions of credit may be more difficult for a debtor to obtain postbankruptcy. *See* Katherine Porter & Deborah Thorne, *The Failure of Bankruptcy's Fresh Start*, 92 CORNELL L. REV. 67, 122 (2006). In terms of nonpecuniary costs, debtors must struggle with the stigma associated with filing for bankruptcy. *See* Teresa A. Sullivan, Elizabeth Warren & Jay Lawrence Westbrook, *Less Stigma or More Financial Distress: An Empirical Analysis of the Extraordinary Increase in Bankruptcy Filings*, 59 STAN. L. REV. 213 (2006) (concluding that, over a twenty-year period, the stigma of bankruptcy has increased).

[36] *See* 11 U.S.C. § 707(b)(1) (2006) (providing for dismissal of a Chapter 7 case on the basis of abuse); *id.* § 707(b)(3)(A) (providing that a bad-faith filing of a Chapter 7 petition can constitute an abuse).

[37] *See id.* § 1325(a)(7) (providing that a court may not confirm a Chapter 13 plan unless "the action of the debtor in the filing the petition was in good faith"); *id.* § 1307(c)(5) (providing that denial of confirmation of a Chapter 13 plan constitutes cause for dismissing a debtor's

Chapter 13 case). For the argument that, as a statutory matter, a debtor's good faith is an improper consideration in analyzing a claim of undue hardship, see Pardo & Lacey, *Undue Hardship in the Bankruptcy Courts, supra* note 1, at 514-19.

[38] If the debtor is represented by counsel, the debtor's attorney must file a declaration or affidavit to this effect. *See* 11 U.S.C. § 524(c)(3)(B). If the debtor is unrepresented by counsel, the court must make that determination. *See id.* § 524(c)(6)(A)(i).

[39] *See id.* § 524(m)(1).

[40] *See id.*

[41] Professor Lacey and I have previously described this burden as imposing upon student-loan debtors "the unenviable and nearly impossible task of proving a negative about their future—that is, convincing the court that nothing could improve their financial circumstances." Pardo & Lacey, *Undue Hardship in the Bankruptcy Courts*, *supra* note 1, at 512.

[42] Pardo & Lacey, *Undue Hardship Discharge Litigation*, *supra* note 1, at 183.

[43] H.R. 3221, 111th Cong. (as passed by the House of Representatives, Sept. 17, 2009).

[44] Pardo & Lacey, *Undue Hardship Discharge Litigation*, *supra* note 1, at 235.

Mr. COHEN. Thank you, Professor Pardo. Appreciate your testimony.

Our third witness is Doug Cuthbertson. Mr. Cuthbertson is a member of Miles & Stockbridge, a commercial business litigation practice in northern Virginia. He practices commercial law and contracts, consumer financial services, business torts, intellectual property, and bankruptcy litigation, real estate, and creditors rights.

He has represented secured and unsecured creditors in adversary proceedings and contested matters in bankruptcy cases. He also represents financial institutions and consumer financial services litigation in the Federal system.

Thank you for being here with us today, Mr. Cuthbertson, and we are going to recognize you for your testimony.

TESTIMONY OF J. DOUGLAS CUTHBERTSON, MILES & STOCKBRIDGE, P.C.

Mr. CUTHBERTSON. Thank you, Chairman Cohen, and Chairman Conyers, Ranking Member Franks, other Members of the Subcommittee, thank you for inviting me to testify before you today. I have been asked to appear to testify as to the effectiveness of the undue hardship discharge provision as it currently exists in the Bankruptcy Code. My testimony is that of an attorney. I am not here representing a client or my firm.

The exception to the discharge for educational loans was enacted in 1976, and the reason that it was enacted was in response to a flood of student loan bankruptcies in which debtors were filing for bankruptcy based almost solely on student loan debt. The nondischargeability provision had two goals: to maintain the financial integrity of the student loan system, and to curb abuses by recent graduates who have their whole earning lives—earning capacity—ahead of them.

One reason that the exception to discharge is particularly important for educational lenders in both the Federal and the private system is the underwriting criteria that the lenders use. Historically, private educational lenders have only regarded a student's future capacity to repay.

That is in stark contrast to other types of commercial and business loans that are made in the private sector, where debtors will generally regard a host of factors, including current ability to repay, credit history, future ability to repay, the value of any collateral securing the loan. None of those considerations are present in educational loans.

The congressional purposes of maintaining the financial integrity of the student loan system as well as curbing abuses of the system apply equally to Federal loans as well as to private loans, and the Congress implicitly recognized this in the 2005 BAPCPA amendments, when it amended Section 523(a)(8) to include qualified educational loans. That includes most private loans, so Congress has treated them both the same.

And it is important to recognize, I think, that private loans supplement the Federal loans. They are meant to be a supplement to cover the college—the rise in college costs, and they are rapidly.

And so private loans have become an important source of additional funding for education for students.

Without the undue hardship standard, borrowers could enjoy the benefits of their education without having to repay their loans—without even attempting to repay their loans—by filing for bankruptcy immediately upon graduation. In the private sector private loan industry there is concern that this would lead to one of three consequences: first, that private loans would no longer be made; private sector lenders would no longer make private educational loans.

You know, they could also require a cosigner or tighten up credit granting criteria. And then the third concern that has been expressed to me is that students would simply use private loans instead of Federal loans, knowing that they are fully dischargeable immediately upon graduation.

Congress has not defined the term "undue hardship," which has led to judicial interpretation of that term and reliance on case law. The grounds generally include illness, incapacity, extraordinary or unique circumstances, like, just, you know, total permanent disability, provision for dependent children, et cetera.

But it is important to note that since it was not defined in the code the case law has developed—a well-developed body of case law, frankly—has developed—and the inquiry is very factually-intensive and it requires a trier of fact to make these determinations. The bankruptcy judges here, who are the triers of fact, are in the best position to evaluate the circumstances of each particular debtor's case.

The standard works relatively well, but I will say because of the factually-intensive nature of the inquiry, there will be more compelling stories, you know, that—where students have not received a discharge. Equally, there will be compelling stories where they have. So it varies on a case-by-case basis, but that is the only way it can in our system of litigation.

I would also point out that bankruptcy is a last recourse for debtors. There are certain other administrative benefits that they can avail themselves of to mitigate student loan debt.

Chairman Cohen, Representative Franks, thank you for the opportunity to testify before you today. I will be happy to answer your questions.

[The prepared statement of Mr. Cuthbertson follows:]

PREPARED STATEMENT OF J. DOUGLAS CUTHBERTSON

Testimony of

J. Douglas Cuthbertson
Principal, Miles & Stockbridge P.C.

BEFORE THE COMMITTEE ON THE JUDICIARY,
SUBCOMMITTEE ON COMMERCIAL AND ADMINISTRATIVE LAW,
OF THE UNITED STATES HOUSE OF REPRESENTATIVES

Regarding

"HEARING ON AN UNDUE HARDSHIP? DISCHARGING EDUCATIONAL DEBT IN BANKRUPTCY"

September 23, 2009

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Chairman Conyers, Chairman Cohen, Ranking Member Franks and other distinguished members of the Subcommittee, thank you for the opportunity to testify before you today regarding the undue hardship discharge for educational loans in bankruptcy.

My name is Douglas Cuthbertson. I am an attorney engaged in the private practice of law in McLean, Virginia. I am a principal with the law firm of Miles & Stockbridge. I practice commercial and business litigation, and specifically, I represent financial institutions in consumer finance litigation in federal court. In my practice, I represent student lenders, servicers, collectors and federal guaranty agencies in a wide variety of litigation matters. I also represent secured and unsecured creditors in adversary proceedings in bankruptcy cases. I am counsel for the National Council of Higher Education Loan Programs, Inc. and several guaranty agencies under the Federal Family Education Loan Program ("FFELP") as *amici curiae* in support of the Petition for Writ of *Certiorari* in the case of *United Student Aid Funds, Inc. v. Espinosa*, which is pending before the Supreme Court.

I have been asked to appear before you today to testify about the effectiveness of the undue hardship discharge for educational loans as it currently exists under the Bankruptcy Code. My testimony is that of a practicing attorney; I am not appearing before you today on behalf of a client or in a representative capacity.

The exception to discharge for educational loans is one of many exceptions in the Bankruptcy Code to the general goal of a "fresh start" for debtors. Congress created these exceptions to the general rule of dischargeability because it believed that the creditors' interest in recovering full payment of debts in these categories outweighs the debtors' interest in a complete fresh start.

The exception to discharge for educational loans is codified at 11 U.S.C. § 523(a)(8). Congress enacted the exception in the 1970s in response to bankruptcies in which recent graduates filed for relief based primarily on student loan debt. The nondischargeability provision has two goals: (1) maintaining the financial integrity of the student loan system; and (2) curbing abuse by recent graduates, who have their whole lives of earning capacity before them.

One reason for the exception was the underwriting criteria of student lenders. Historically, student lenders have underwritten and funded private educational loans looking toward the student's future earning capacity as a source of repayment. Lenders making FFELP loans have no true underwriting criteria. With some exceptions, if a student is enrolled in a degree-granting program of an approved educational institution, he or she can receive a FFELP loan up to the maximum amount. In contrast, lenders that make other commercial and personal loans generally look to a borrower's current ability to repay and the value of collateral (such a car or a house) securing the loan. Neither of these criteria is present in most educational loans.

The Congressional purposes of maintaining the financial integrity and preventing abuses of the student loan system apply equally to both FFELP loans and private loans. Without the undue hardship standard, borrowers could enjoy the benefits of their education and file bankruptcy without ever attempting to repay, leaving lenders with no assets or other way to get repaid. Essentially, borrowers would be converting a student loan (whether FFELP or private) into a scholarship. With respect to private loans, removing the exception to discharge would have one of three effects: (1) lenders would decide to no longer make private loans—a real concern in this credit environment; (2) private loan lenders would increase interest rates or insist on a co-borrower; or (3) borrowers could chose to take out private loans rather than FFELP loans with the intent to discharge all of the loans after graduation. In other words, students may have a motivation to take out a higher cost private loan over a lower cost FFELP loan, thus damaging the integrity of the educational loan system.

Moreover, abrogating the exception to discharge for educational loans would be unfair to student lenders. Lenders who have served in the FFEL program have put their capital and work into the program predicated on the existing limitations on dischargeability. The same is true of lenders making private sector loans. These limitations have, in turn, been leaked into the pricing structure for securitizations, or at least no allowance has been made for dischargeability features in respect of these securitizations.

The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCPA") amended Section 523(a)(8) to include an exception to discharge for "qualified education loans." The definition of qualified education loan includes most, but not all, private student loans. Thus, Congress treated FFELP and private loans the same. Private loans generally supplement FFELP loans. But due to the rapidly rising cost of higher education, private loans are an important source of educational funding for students. Removing the undue hardship standard for private loans would increase the cost of private student loans and decrease access to higher education.

Congress did not define "undue hardship," which has led to reliance on judicial interpretation. As a result, there is a well-developed body of law on this issue. The grounds for an undue hardship generally include illness, incapacity, extraordinary medical expenses, very low income and provisions for dependents. The key is not whether these factors exist, but the level they need to reach before they become "undue."

As with any factually intensive inquiry in our system of civil litigation, the trier of fact—here, a bankruptcy judge—is best situated to decide the issue of whether a student loan debt is an undue hardship on a debtor in light of the particular circumstances of each case. Courts have not required debtors to live at the poverty level in order to discharge their student loans. They also take into account a debtor's good faith effort to repay his or her student loans. Because of the factually intensive nature of the inquiry, in some cases, debtors are granted a discharge, and in others, they are not. But that is how Congress wrote the law, and the courts are obligated to follow it. Congress may give further direction reforming the undue hardship standard to ensure that it is being applied in a uniform manner in bankruptcy courts throughout the country. But the substantial body of law that has been developed in this area has proven to be workable and effective in preserving Congress' balanced goals of hardship discharge, while giving debtors a fresh start in bankruptcy.

The Second Circuit adopted the most widely accepted test in *Brunner v. New York State Higher Educ. Serv. Corp. (In re Brunner)*, 831 F.2d 395 (2d Cir. 1987). The *Brunner* test requires a debtor to show that: (1) the debtor cannot maintain a minimal standard of living and repay the loans; (2) exceptional circumstances exist that show that the debtor will not be able to repay the loans for a significant portion of the repayment period; and (3) the debtor has made a good faith effort to repay the loans. The *Brunner* test is the majority rule.

Under the *Brunner* test, courts evaluate debtors' current income and expenses to determine whether they can repay their student loans while maintaining an acceptable standard of living. Debtors must show that they are actively minimizing their current expenses and maximizing their personal resources. This requires a review of the reasonableness of the expenses budgeted by the debtor and an inquiry into his or her efforts to secure employment. Many courts look to the United States Department of Health and Human Services Poverty Guidelines to establish a base line for "minimal standard of living." But the guidelines are not determinative. Courts have allowed debtors with income in excess of the poverty level to discharge their student loans. In doing so, the courts have stated that Congress did not intend that a fresh start under the Bankruptcy Code means that families have to live at the poverty level.

Debtors also must show that there is something exceptional that makes their situation likely to persist. This requirement reflects the goal that students should not be able to discharge student loan obligations immediately upon graduation because they have their whole earning lives ahead of them. Generally, debtors' income increases over time. Debtors seeking a discharge must demonstrate a unique misfortune, disability or disadvantage—such as lack of job skills, lack of available jobs, and physical or mental disabilities—to show that their situations will not improve in the future. The required hardship must be more than the usual hardship that accompanies bankruptcy. Every debtor in bankruptcy has financial hardship—the question is whether it rises to the level of "undue" hardship.

It is not an undue hardship if a debtor is, and always will be, unable to find employment in his or her chosen field. The analysis does not focus on the debtor's ability to make good career choices, but rather on his or her ability to make a living in any field. The courts have stated that student lenders do not insure the value of an education.

Finally, student loan debt is not dischargeable unless the debtor can show that he or she has made a good faith effort to repay the loan. The debtor's own actions should not contribute to his or her inability to repay his loans. Things like buying a new car, sending children to expensive private schools, repaying other dischargeable loans, failing to negotiate payments before seeking a discharge and filing a petition too soon after completing the education may tend to evidence a lack of good faith. On the other hand, requesting a deferment or consolidating loans shows a good faith effort to repay. The case law shows an emphasis not necessarily on actual payments made, but on efforts to address the obligation.

Importantly, for today's hearing, debtors who are unable to pay loans originated in the federal student loan programs are not without redress for an overburdening set of economic circumstances occasioned by student loan debt load. There are various forms of borrower benefits relating to income, health and public service that allow borrowers to mitigate the effects of student loan debt. The most recent of these is Income-Based Repayment, established to provide borrowers within the FFELP program a way to make lowered payments.

Applying current law to the facts in an exercise of sound judicial discretion, bankruptcy judges can best determine whether loan debt is an undue hardship on a debtor in light of the particular circumstances of each case. In contrast to a process where a bankruptcy judge makes a careful assessment of undue hardship, some courts have recently ruled on the issue of whether debtors can effectively discharge student loans merely by completing a confirmed Chapter 13 plan containing discharge language. Some courts have held that language attempting to discharge student loans in this manner is sanctionable. Others have held that the appropriate vehicle for determining the dischargeability of student loans is an adversary proceeding.

This issue is before the Supreme Court in the case of *United Student Aid Funds, Inc. v. Espinosa*. In that case, the Ninth Circuit adopted a rule allowing discharge-by-declaration, *i.e.*, discharge of student loan debt in bankruptcy through a declaration of discharge in a Chapter 13 plan, if the creditor does not object to the plan, without requiring proof of undue hardship in an adversary proceeding. The administration has filed an *amicus* brief in *Espinosa*, supporting the creditor's position that the bankruptcy court's discharge order did not discharge Espinosa's student loan debt.

Removing the exception to discharge for educational loans would tighten credit, decrease access to education, reduce responsibility and accountability, and drive lending into the public sector. As a result, Congress instead should focus its efforts on taking action to help reduce rising educational costs and increasing post-graduation employment.

Thank you for holding this hearing and for the opportunity to appear before you today.

Mr. COHEN. Thank you, Mr. Cuthbertson. I appreciate your testimony.

Our final witness, our cleanup batter, is Brett Weiss. Mr. Weiss currently heads the Bankruptcy and Insolvency Group at Joseph, Greenwald & Laake. He is experienced in all the chapters—11, 13, and 7. And he has represented individuals, corporate debtors, and creditors in all phases of bankruptcy.

We thank you for your willingness to testify, and would you begin your testimony?

TESTIMONY OF BRETT WEISS, JOSEPH, GREENWALD & LAAKE, P.A.

Mr. WEISS. Thank you, Mr. Chairman, and Members of the Subcommittee. Good afternoon. I am Brett Weiss, a bankruptcy attorney from Greenbelt, Maryland.

I appear today on behalf of the National Association of Consumer Bankruptcy Attorneys, NACBA, and the National Consumer Law Center, NCLC. NACBA is the only national organization dedicated to serving the needs of consumer bankruptcy attorneys and protecting the rights of consumer debtors in bankruptcy. The nonprofit NCLC specializes in consumer issues and has established the Student Loan Borrower Assistance Project, which provides information about student loan rights and responsibilities.

I appreciate the opportunity to speak with you about an issue I deal with on a daily basis: the harsh treatment of student loans in bankruptcy. Most Americans see a college degree as the single most important factor for financial success and a place in the middle class, but with skyrocketing tuition and related expenses, more and more students are forced to turn to loans to pay for that education.

I have three teenaged daughters. One is a college freshman, another a high school senior, and a third is in her last year of middle school. I can't afford out-of-state tuition and costs for all three—over $120,000 each for 4 years. And that isn't even for a top-tier college, where those expenses can easily run $50,000 a year, $200,000 at the time of graduation.

Two-thirds of all college students borrow money to pay for college, and due to high tuition and low Federal loan caps, an increasing number take out private student loans. What borrowers are finding is that there is no margin of error when it comes to student loans. Students who choose public service or other low-paying careers or whose education doesn't provide the opportunities they expected too often begin their adult lives with student loans they can't pay, creating a financial black hole from which they may never emerge.

I see these people in my office every day, and since the 2005 bankruptcy law gave private student loans the preferential treatment previously reserved for government-guaranteed student loans, there is little I can do to help. These loans are not dischargeable except under very extreme circumstances, and even there there is a very high cost for them to be able to pay an attorney to represent them in the protracted litigation that Mr. Cuthbertson referred to.

Private student loans are huge profit centers for lenders while student often find themselves loaded with high-interest rates and mountains of debt. Indeed, interest rates and fees on private loans can be as high as those on credit cards, and unlike Federal student loans, there is no limit on the size of the private loan and minimal regulation of their terms and costs.

Like other private loans, private student loans are made and priced based on risk. There is simply no public policy justification to treat this one type of private loan differently by denying a discharge solely because of how the money is used.

The discharge is a fundamental purpose of individual bankruptcy, providing the unfortunate but honest debtor an important fresh start. Exceptions to discharge should be carefully considered and adopted only when necessary to further other important policies. Because private student loans are usually made at market rates and on the same basis as other loans, we see no reason to give them special treatment in bankruptcy.

Some raise the illusory argument that without this special treatment private student loans will become more expensive and less available. Allowing discharge in bankruptcy won't affect their ability—availability, however, anymore than, as Mr. Chairman noted, allowing the discharge of credit card debt and mortgage debt restricts the availability of those types of loans.

The private student loan industry was expanding rapidly before the 2005 amendments. That expansion likely would have continued regardless.

And even after giving them the additional protection in BAPCPA, we did not see expanded availability or a reduction in interest rates. This suggests that there will be minimal, if any, reduction in lending if the law is returned to its pre-2005 status and private student loans become dischargeable once again.

You have already dealt with businesses that are too big to fail. Let us not forget those who currently seem to be too small to help.

NACBA and NCLC urge this Subcommittee and the full Congress to repeal the preferential treatment extended to private student lenders in the 2005 amendment. Thank you very much.

[The prepared statement of Mr. Weiss follows:]

PREPARED STATEMENT OF BRETT WEISS

Testimony of Brett Weiss and Deanne Loonin for the

U.S. House of Representatives Committee on the Judiciary

Subcommittee on Commercial and Administrative Law

regarding

"Undue Hardship? Discharging Educational Debt in Bankruptcy"

September 23, 2009

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National Association of Consumer Bankruptcy Attorneys

Mr. Chairman and Members of the Committee, the National Association of Consumer Bankruptcy Attorneys (NACBA) and the National Consumer Law Center (NCLC) thank you for holding this hearing today. The National Association of Consumer Bankruptcy Attorneys is the only national organization dedicated to serving the needs of consumer bankruptcy attorneys and protecting the rights of consumer debtors in bankruptcy. Formed in 1992, NACBA has over 4,000 members located in all 50 states and Puerto Rico. NACBA's members represent a large proportion of the individuals who file bankruptcy cases in the United States Bankruptcy Courts.

The National Consumer Law Center (NCLC) submits this testimony on behalf of our low-income clients. The National Consumer Law Center is a nonprofit organization specializing in consumer issues on behalf of low-income people. We work with thousands of legal services, government and private attorneys, as well as community groups and organizations, from all states that represent low-income and elderly individuals on consumer issues.[1] NCLC's Student Loan Borrower Assistance Project provides information about student loan rights and responsibilities for borrowers and advocates. We also seek to increase public understanding of student lending issues and to identify policy solutions to promote access to education, lessen student debt burdens and make loan repayment more manageable.[2]

Introduction: An Unfair System Based on False Assumptions

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. This harsh treatment of students in the bankruptcy system was built on the false premise that students were more likely to "abuse" the bankruptcy system. Yet there is no evidence and has never been any evidence to support this assumption.

When first considering this policy, Congress commissioned a Government Accountability Office (GAO) study on the topic which found that only a fraction of 1 percent of all matured student loans had been discharged in bankruptcy. The House report summarized the GAO's findings:

> First, the general default rate on educational loans is approximately 18%. Of that 18%, approximately 3-4% of the amounts involved are discharged in bankruptcy cases. Thus, approximately ½ to ¾ of 1% of all matured educational loans are discharged in bankruptcy. This compares favorably with the consumer finance

[1] In addition, NCLC publishes and annually supplements practice treatises which describe the law currently applicable to all types of consumer transactions, including *Student Loan Law* (3d ed. 2006 and Supp.).
[2] *See* the Project's web site at http://www.studentloanborrowerassistance.org.

industry. [3]

Congress acknowledged the pressure from the anecdotal reports of abuse. For example, a 1977 House Report on this issue stated that:

> The sentiment for an exception to discharge for educational loans does not derive solely from the increase in the number of bankruptcies. Instead, a few serious abuses of the bankruptcy laws by debtors with large amounts of educational loans, few other debts, and well-paying jobs, who have filed bankruptcy shortly after leaving school and before any loans became due, have generated the movement for an exception to discharge. In addition, a high default rate has been confused with a high bankruptcy rate, and has mistakenly led to calls for changes in the bankruptcy laws.[4]

Despite the shaky foundation, Congress ignored the study and instead chose to make it more and more difficult for student loan borrowers to get a fresh start through bankruptcy.

After a series of changes which eliminated borrower rights, the final blow to students came in 2005 when Congress included private student loans in the non-dischargeability category. Private student loans are made by lenders to students and families outside of the federal student loan program. They are not subsidized or insured by the federal government and may be provided by banks, non-profits, or other financial institutions. Unfortunately, many private student lenders followed the path of the subprime mortgage industry and pushed high priced, unaffordable loans on students.

Diana, a mother of a college age son in West Virginia, told of her family's recent experiences with one such private lender:

> As a freshman at University of West Virginia, her son "…received scholarships and federally subsidized student loans that covered most of his tuition, room and board. Unbeknownst to his father and me, he began applying online for less conventional rate student loans to cover an estimated $1,800 balance. He had absolutely no credit history and absent a cosigner, most applications were denied. [The creditor's] student loan division, however, swiftly approved him for a $14,000 loan.
>
> About a week after the check arrived, a disclosure statement followed that detailed a prepaid origination fee of $580 and a staggering total repayment of $57,327.79. Our naïve son thought that the interest rate was fixed; it was not. It is a variable rate that is currently at 11.3%.
>
> We convinced him to send the check back, but when he called [the private creditor], a representative talked him into keeping it….We are outraged. [The private creditor] is clearly preying on and exploiting vulnerable and financially naïve students who will clearly be saddled with outrageous, crushing debt upon graduation."

[3] H.R. Rep. 95-595, 1st Sess. 1977, 1978, 1978 U.S.C.C.A.N. 5963, 6094, 1977 WL 9628.
[4] Id.

The idea that students are more likely to file for bankruptcy also assumes that this decision is cost-free when in fact there are many negative consequences, such as damage to credit rating. Further, in 2005, Congress added a number of new elements to the personal bankruptcy system, such as a means test and counseling requirements, that make it more difficult for all consumers to file bankruptcy, especially those who have assets to pay their debts. In any case, the Bankruptcy Code has always included safeguards to prevent discharge in cases where debt is obtained through false pretenses or fraud.

On one hand, we tell young people as they grow up that they have a much better chance of success if they go to college. Yet we give these students no margin for error if college does not work out for them financially, even though it is in our national interest for more people to get post-secondary education or training. It would be better for society and our economic future if individuals were allowed some flexibility to take chances. If public policies only encouraged safe choices, few would borrow to go to college. Few would start businesses either. Most businesses fail, even those started by those who have previously run successful businesses.[5] Yet we have decided as a society that we want people to start businesses even if this means writing off some bad debt. The same principle should apply to education.

An Arbitrary System

To make matters even worse, the current "undue hardship" system is random, arbitrary and unfair. Under current law, most federal and private student loans can only be discharged if the debtor can show that payment will impose an undue hardship on the debtor and the debtor's dependents. The student must seek the hardship determination in court through a separate proceeding. While the current system may deter some student borrowers who can afford to pay their loans, it more often snares those who are truly financially distressed and desperately need relief.

The system is strikingly arbitrary. Judges are granted extraordinary discretion to make these decisions, especially since the Code provides no definition of "undue hardship." Professors Pardo and Lacey have studied this issue and found a high degree of randomness in the application of the undue hardship test.[6] They also found that students seeking bankruptcy relief were in fact suffering financial distress, concluding that judicial discretion has come to undermine the integrity of the undue hardship system.[7]

Many courts use the so-called *Brunner* test to evaluate hardship.[8] This test requires a showing that 1) the debtor cannot maintain, based on current income and expenses, a "minimal" standard of living for the debtor and the debtor's dependents if forced to repay the student loans; 2) additional circumstances exist indicating that this state of affairs is

[5] Megan McArdle, "Sink and Swim" The Atlantic (June 2009).
[6] See Rafael I. Pardo & Michelle R. Lacey, "Undue Hardship in the Bankruptcy Courts: AN Empirical Assessment of the Discharge of Educational Debt", 74 U. Cin. L. Rev. 405 (2005); Rafael I. Pardo, Michelle R. Lacey, "The Real Student-Loan Scandal: Undue Hardship Discharge Litigation", 83 Am. Bankr. L.J. 179 (Winter 2009).
[7] Id.
[8] *Brunner v. New York State Higher Educ. Servs. Corp.*, 831 F. 2d 395 (2d Cir. 1987).

likely to persist for a significant portion of the repayment period of the student loans; and 3) the debtor has made good faith efforts to repay the loans.

In recent years, many judges have recognized the random and unfair application of this "test." According to the Tenth Circuit, many courts have "…constrained the three *Brunner* requirements to deny discharge under even the most dire circumstances."[9] The court further noted that this overly restrictive application fails to further the Bankruptcy Code's goal of providing a "fresh start" for the honest but unfortunate debtor.[10] In criticizing the test, another judge noted that *Brunner* was "…made up out of whole cloth anyway."[11] Among other nearly impossible barriers, the test forces borrowers to prove a negative—They must somehow prove that their future is as hopeless as their present.

Other courts have taken the *Brunner* test to the extreme of requiring that a borrower show a "certainty of hopelessness." In rejecting this analysis, some courts have blamed its widespread use on an erroneous reading of *Brunner*.[12]

Courts have taken the long journey from "undue hardship" to "certainty of hopelessness" because of the lack of guidance in the Code. Without such guidance, judges have freely injected their own views about what types of expenses are legitimate and whether a borrower is truly trying hard enough to earn a maximum income. This leads to results such as a 1994 decision where a debtor who had nerve damage, bronchitis, and arthritis, and whose daughter had epilepsy, mother had cancer and grandchildren had asthma, failing the Brunner "good faith prong" because she intentionally (and apparently wrongly in the court's view) chose to help her family financially.[13]

The Costs of Undue Hardship Litigation

The current system is stacked against the most financially distressed borrowers. These borrowers have few, if any, resources to pay for legal assistance to prove to judges that they suffer from undue hardship.

Yet competent legal assistance is one of the key factors in determining whether a borrower will successfully get a discharge. Professors Pardo and Lacey found that the extent of relief obtained by debtors turned more on extralegal factors than legal factors, including the identity of the creditor, the manner in which the adversary proceeding was resolved, identity of the judge and whether the debtor was represented by a highly experienced attorney.[14]

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[9] *ECMC v. Polleys*, 356 F. 3d 1302 (10th Cir. 2004).
[10] Id.
[11] *In Re Cummings*, 2007 WL 3445912 (Bankr. N.D. Cal. Nov, 13, 2007).

[12] *In re King*, 368 B.R. 358 (Bankr. D. Vt. 2007)
[13] *In re Stebbins-Hopf*, 176 B.R. 784 (Bankr. W.D. Tex. 1994),
[14] Rafael I. Pardo, Michelle R. Lacey, "The Real Student-Loan Scandal: Undue Hardship Discharge Litigation", 83 Am. Bankr. L.J. 179 (Winter 2009).

Unlike a typical consumer bankruptcy case, a student loan borrower must affirmatively seek an undue hardship determination. This requires filing a complaint, often conducting extensive discovery, and preparing evidence for trial. These are time-consuming cases. The small subset of bankruptcy lawyers that handle these cases generally charge high fees. The sad fact is that there are very few lawyers that are willing or able to handle these cases through free legal services or on a pro bono basis.

Without legal assistance, these borrowers must litigate undue hardship while going up against aggressive creditor lawyers. A borrower seeking no more than a fresh start must open up every aspect of his/her private life and defend it. Creditors have presented a wide range of aggressive arguments to discredit borrowers' testimony about hardship. In one recent case, creditors aggressively questioned a woman about why she had children after she took out student loans if she was not going to be able to afford both children and loans.[15] In this case, the creditor's counsel got the borrower to acknowledge that she had borne all of her children after she took out the loans. He then asked her if her children had been "planned" to which she responded that she was Catholic. Counsel then dropped the subject until closing argument, at that time referring to her religious choice. Counsel said that "you have to make the decision to have a family in light of what you can afford."

The arbitrary system hits lower-income borrowers particularly hard. Even if they have access to free or low cost legal assistance, they still must find resources to pay for depositions and in some cases even expert witness testimony. Even with strong testimony, it is nearly impossible to predict outcomes since so much rides on which jurisdiction the borrower happens to live in and which judge she draws. Inconsistency and unfairness have destroyed the credibility of the system. One judge noted the importance of a student loan program operating free of the "…cynicism that would infest the system if a disparate standard for discharge of loans would develop, leaving some students enduring the hardship of making loan payments while others are freed of their commitment on a floating standard."[16] Unfortunately, this is the state we are in.

The Impact on Co-Borrowers and Victims of Rip-Off Schools

There are subsets of borrowers that are particularly impacted by these inequities. Most courts, for example, have extended the same restrictive standards to co-borrowers. We recently heard a particularly poignant experience from a co-borrower looking for solutions:

> Heather from St. Petersburg, FL (in her words)
>
> I co-signed for my boyfriend's loans so that he could go to school to become a pilot. When he signed up with the school, they only had 2 banks they wanted us to get loans through (Wachoiva or Sallie Mae and only one that was accessible from their web site (Wachovia) where he was supposed to sign up for the loan. So we ended up getting a private loan from Wachovia (which is backed by TERI) instead of a federal loan, although I'm not sure what the difference is. Unfortunately, he passed away a couple of weeks before his training was complete. Now the loan deferment period is

[15] *In re Walker*, 406 B.R. 840 (D. Minnesota June 18, 2009).
[16] *ECMC v. Polleys*, 356 F. 3d 1302 (10th Cir. 2004) (J. Lucero concurring opinion).

> coming to and end and obviously they want their money. I've done some outreach to see what my options are and it's not looking very promising… They also sent a letter, addressed to him, stating that the loans don't offer a death discharge….. I understand that I am responsible for paying these loans since I did co-sign for them, it just doesn't make sense for me to pay the entire loan amount when I got nothing from them, didn't even get to go for a ride!

Most courts are similarly unmoved by borrowers who went to fraudulent schools. Most courts have struggled to fit the concept of "educational benefit" into the undue hardship analysis even in cases where the school closed while the borrower was in attendance or was otherwise a sham school.[17] Many courts assume that these borrowers can get relief instead through the Department of Education administrative discharges. This may be true in some cases, but there are many limits to these discharges which most bankruptcy judges are not aware of. First, these discharges apply only to federal student loans. In addition, many borrowers fall through the cracks of the limited closed school, false certification, and unpaid refund eligibility provisions. Not one of these discharge programs provides general remedies for borrowers who attended a fraudulent school. For example, a school may routinely pay admissions officers by commission in violation of incentive compensation rules, fail to provide educational materials or qualified teachers, and admit unqualified students on a regular basis. None of these violations is a ground for cancellation. Instead, each cancellation offers relief for a narrow set of circumstances.

Lack of Non-Bankruptcy Alternatives

The bankruptcy policy might not be so harsh if borrowers had ample non-bankruptcy alternatives to address student loan problems. There are many options in the federal loan programs, although these should not be viewed as substitutes for bankruptcy discharges in all cases. Private loans, however, are another story.

Given their role in creating the crash, it is reasonable to expect lenders to do everything possible to help borrowers with unaffordable loans. Distressingly, this has not occurred. In NCLC's experience representing borrowers through the Student Loan Borrower Assistance Project. we have found private lenders to be universally inflexible in granting long-term repayment relief for borrowers. Lenders that had no problem saying "yes" to risky loans are having no problem saying "no" when these borrowers need help.

In NCLC's April 2009 report, "Too Small to Help: The Plight of Financially Distressed Private Student Loan Borrowers", we found that private lenders appear to be offering some flexible repayment options for financially distressed borrowers.[18] Private lenders, however, do not offer income-based repayment. In addition, these lenders rarely cancel loans or offer reasonable settlements. For example, private lenders generally do not

[17] *See, e.g., In re Gregory* 387 B.R. 182 (N.D. Ohio 2008) (Relief on the basis of fraud can be had only against those who are shown to be parties to the fraud).

[18] The report is available on-line at: http://www.studentloanborrowerassistance.org/uploads/File/TooSmalltoHelp.pdf.

discharge student loan debt upon death of the original borrower or co-signer. Further, loan modifications are rarely offered. Fundamentally, lenders who make private student loans are not obliged to offer repayment modification or relief under any circumstances, leaving borrowers truly at the mercy of their lenders.

The options are particularly limited for borrowers in default. Yet these are generally the borrowers most desperate for assistance. This is also in sharp contrast to the federal student loan programs where borrowers in default have various ways to select affordable repayment plans and get out of default.

In the past, forbearance was the only option private student lenders offered to these most distressed borrowers. However, these policies have changed radically in recent months as most creditors have sharply restricted forbearance availability. The problem for borrowers is not so much that forbearances are less available, but that there are few or no other options to help them manage their debts over the long-term. Forbearances are not the best long-term debt management tool because interest accrues during the forbearance period, but it is the only tool many borrowers have traditionally been offered to stave off default.

We constantly hear from borrowers who are desperate to work something out with their lenders only to have the door slammed in their faces. Here are accounts from a few such borrowers:

1. Patrick from the Greater Boston Area, MA

Patrick's mother was one of NCLC's clients. Patrick was 22 years old in 2006, just a semester away from graduating from the University of Rhode Island, when his life changed forever. He suffered a terrible accident, falling down a long escalator and suffering severe brain damage. His parents, doctors and nurses have fought hard to keep him alive, but the prognosis is not good. Patrick is in a minimally conscious state and is incapable of consistent communication, fully dependent upon others for all of the activities of daily life.

Patrick's family has struggled to find resources to pay for his care. There was no appropriate care available in Massachusetts, so they are paying for private care in New Hampshire. They are also using up their retirement and other resources to retrofit their home so that it will be accessible for Patrick when they bring him home.

Patrick took out federal loans to finance his education and also worked during the summers to earn money for college. His federal loans were discharged based on permanent and total disability. He also used private loans to help fill the gap. To get a better rate, his mother co-signed on the loans. These were not the highest rate private loans. Because Patrick's Mom co-signed, they were able to get a decent interest rate. The problem is the lack of a safety net when this tragedy occurred.

Patrick's Mom has struggled to make the monthly payments. She has done so up until now, but the extra resources needed to pay for Patrick's care have put her over the edge. In addition, her husband was recently diagnosed with a serious illness. Patrick's Mom has asked the lender to forgive the remaining balances. Alternatively, she has offered to settle the debt for less than the amount owed through payment of a lump sum. To date, the lender has refused, offering nothing more than short-term forbearances or short periods of interest only payments.

2. Monica from Dallas, TX (in her own words)

I have two loans, one of which is private. Two times today, I tried to resolve my private loan that is in default. First speaking with a woman who called me and second speaking with a woman who I called. Both times, the women were very rude and spoke over me, not allowing me to speak or ask any questions. ..She told me she didn't care about my situation and that if I don't get out my check book and pay them a deposit, they are going to sue me. I told her I was calling to try to resolve my issue, that I called them and I am not trying to avoid payment. She hung up on me. I called with the intent to help the situation I was on and try to get on the right rack, and honestly, put down the phone wanting to shoot myself.

Even the Middle Ground is Arbitrary

Many courts, recognizing the inequity of this system, have begun to create an ad hoc middle ground. Some allow partial relief by discharging a portion of the debt or by discharging some, but not all, of the loans. Some courts have allowed a restructuring of the loan, for example by discharging collection fees and accrued interest and even by delaying the student's obligation to start making payments, during which time no further interest accrues.

Whether a borrower gets the benefit of a middle ground approach depends entirely on where she happens to live and the judge she happens to draw. This is unfair, but the judges have a point. They are flying by the seat of their pants without any foundation in the bankruptcy code because they understand that the current all or nothing approach is unfair.

Effect on the Student Loan Business

Many creditors argue that treating student loans the same as other debts in bankruptcy would create greater risk for them. This is far from obvious. If most borrowers who file for bankruptcy cannot afford to repay their debts, a more restrictive bankruptcy policy is not going to make them more able to pay.

It is certainly true that private student loans, made without government guarantees, can be risky for both creditors and borrowers. Many students are young, with little or no credit history. Their earning power is mostly speculative. Yet responsible underwriting of student loans is not impossible. Recent trends in the industry show that creditors know how to sell less risky products.

Mr. COHEN. Thank you, Mr. Weiss.

And I want to compliment our panel—the first panel we have ever had to conclude on the red light. And I recognize myself now for 5 minutes of questioning.

Professor Pardo, you mentioned a couple possible legislative suggestions. One of them was to clarify, change, make constant the definition of undue hardship, I believe, and the other was maybe the 86 on the undue hardship, get rid of it.

Those are different solutions. Which do you think is preferable?

Mr. PARDO. Well, based on what my studies have shown me and in an ideal world if we could start from scratch, I would say that all student loans should be dischargeable in bankruptcy. But I realize we are not at that point today; it might be hard to unscramble the egg.

So I propose two solutions. I think the ideal at this point is to undo the preferential treatment for private student loans, and at the same time recognize the difficulties other student loan debtors face in bankruptcy—those who borrow from the Federal Government or nonprofits and the difficulties that they face in litigating their claims of undue hardship—and therefore clarify the standard.

So really, two proposals: If you are going to take the steps to get rid of private student loans, at the same time also introduce legislation that clarifies the undue hardship standard.

Mr. COHEN. So you think we need to do both, clarify the undue—one, clarify the undue hardship standard, and two?

Mr. PARDO. Make private student loans automatically dischargeable.

Mr. COHEN. Well, if they are automatically dischargeable where would you have the undue hardship rule?

Mr. PARDO. The undue hardship rule would continue to apply for either—loans made by the Federal Government, or made by nonprofits, or guaranteed by the Federal Government, or guaranteed by nonprofits.

Mr. COHEN. Okay. Okay. I like your analogy. You know, I have heard about making sausage. I had never heard about the scrambled egg, but now we have got all of breakfast together here in Congress.

Mr. Cuthbertson, I appreciated your testimony, and you have a different perspective, and I understand where you are coming from. And without assuming that your premise is something I concur in, the idea that somebody could mount up a lot of debt, not have gone in the income world, and discharge their debt and then go on and earn their, you know, great bonuses and whatever in the private world of life and income doesn't seem equitable.

Last year Danny Davis' amendment was, like, only could discharge it after 5 years, I believe. Is there some time limit that you think might be agreeable to where we could get the minority to agree to us to make a good egg?

Mr. CUTHBERTSON. Well, I think the law used to contain a time limit in the 1990's, and it was gradually tightened over the years as part of the Clinton administration-supported amendments that changed it from—it had been 5 years and then it was changed to 7, and now taken out altogether. Sure, that is a possible solution.

Congress would be—you know, it would be a reasonable exercise of Congress' power——

Mr. COHEN. Well, we could do a lot, you know, wars—neither here nor there. What do you think would be a reasonable solution to balance that? I mean, you are coming not representing a client, all of a sudden you are the czar.

Mr. CUTHBERTSON. Well, I think I would agree with Professor Pardo that if Congress is going to do anything—take any action in this area—that it should clarify the standards for undue hardship under the code. I think that is what would be most beneficial.

If the concern is, you know, a lack of uniformity across the circuits across the country and the concern is the judges are applying their judicial discretion in a manner that is not uniform, then Congress could provide direction setting out the standards for undue hardship.

Mr. COHEN. Have any or all of you, or which of you have submitted any proposed definition? Have any of you submitted that? No? You could all do that though.

Mr. PARDO. I have pointed in my written testimony to looking at the presumption that exists for undue hardship in the context of the approval of reaffirmation agreements in bankruptcy. So a reaffirmation agreement is when the debtor proposes to repay a debt that otherwise would have been discharged.

If that agreement is to be approved and have legally binding effect, one of the things that must be shown is that it will not impose an undue hardship on the debtor, and with the 2005 amendments Congress included a presumption that basically says, if the debtor's disposable income is insufficient to repay the proposed payments in the agreement there is a presumption of undue hardship, meaning the agreement will not be——

Mr. COHEN. So you think that one flies——

Mr. PARDO. I think that would help a lot in two ways. One is, it would concentrate, again, the analysis of undue hardship on financial criteria, which I have found in my studies aren't driving outcomes. And really, if you look at both of those provisions they ask, "What is the effect of having to repay a loan?"

Mr. COHEN. I am going to ask each of you, if you would after the Committee, to give me what you think is an appropriate legislative remedy on this definition.

Ms. Asher, what do you think about Mr. Cuthbertson's suggestion that these folks can mount up this large debt, wipe it out, and then go on and get into some get-go world?

Ms. ASHER. Well, I think Professor Pardo has already addressed the fact that there was no evidence of abuse of bankruptcy by student borrowers of either type before the bankruptcy laws changed, so I wouldn't expect that to be any different. You have to meet very stringent criteria for bankruptcy, and if you are—if you borrowed something fraudulently it is not eligible for discharge, even under regular discharge rules.

Mr. COHEN. But you wouldn't have borrowed it fraudulently. You would have borrowed it with all good intents and then you graduated and said, "Hey, I can start clean."

Ms. ASHER. Bankruptcy and default are not exactly clean; they have very serious and long-term financial consequences. They can make it hard to get a job or rent an apartment, or do any of the other things that you would need to do to enjoy the benefits of such unlikely behavior. But I am not a bankruptcy lawyer.

So I can say that there—in the industry we have already seen, because of the credit crisis, a significant increase in credit standards and the requirement of cosigners for almost all private loans. While there was some contraction in the industry because of the credit crunch and some very highly leveraged lenders that were making, in many cases, some very high-risk loans, Sallie Mae, Wells Fargo, Citibank, and increasingly credit unions and now some schools are very much still in the private loan game.

There was huge growth, as I think Professor Pardo noted, from 2007—from 1997 to 2005 the private loan industry grew—volume grew by 800 percent. That was without the benefit of this special treatment in bankruptcy.

The industry seems to have a lot of profit opportunity. Sallie Mae still projects that it is going to make a third of its profits or more from private loans, so I think that some of the concerns are either overblown or have already been addressed by a market correction.

Mr. COHEN. Mr. Cuthbertson, are you familiar with Professor Pardo's study?

Mr. CUTHBERTSON. Yes, Chairman, I am.

Mr. COHEN. Where do you question it?

Mr. CUTHBERTSON. Well, I guess I question the conclusion that Professor Pardo reaches that because—if you accept the premise that the undue hardship standard is not being applied uniformly by bankruptcy judges that therefore we should just do away with the undue hardship standard and make private student loans automatically dischargeable.

I think, as I said, I think if there is a problem with the application of the standard, Congress can give further direction on what the undue hardship standard should entail. I don't think it necessarily follows that you just scrap the undue hardship test altogether.

I also would take exception, I think, with the significance placed on what Professor Pardo has called "extralegal factors," those being the experience level of debtor's counsel, creditor's counsel, bankruptcy judges, predispositions to certain issues. I think those things are part and parcel of our system of litigation, and that happens in every court, and, you know, there is nothing inherently wrong with that. That is the way that every individualized factual determination has to be made, and those factors come into play in all types of litigation.

Mr. COHEN. What about his suggestion—and Ms. Asher seems to concur—that there was not a problem with student loans in the past and that there has only been a few exceptions that were highlighted to make it look like there was abuse?

Mr. CUTHBERTSON. Well, I guess I can only say that that is the—that was the stated purpose in 1976, and I don't have empirical data to support that there is a lack of abuse or not.

Mr. COHEN. Thank you, sir.

Mr. CUTHBERTSON. I would be happy to supplement the record.

Mr. COHEN. Everybody has an opportunity to do it and we would be happy to have your remarks, as you will find out later, to submit later to amend it. Thank you.

Now that I have taken over my 5 minutes and been a very poor example to the witnesses who did so good, I recognize my Ranking Member, Mr. Franks.

Mr. FRANKS. Well, thank you, Mr. Chairman.

Mr. Cuthbertson, I suppose that in nearly every business endeavor where there is some type of contractual arrangement, and especially if it is a financial one, that the Bankruptcy Code tries to make a balance between trying to, you know, encourage people to pay their debts and to make it a hard route for them to simply discharge it, and yet to be able to have a pressure relief when it is simply—the hardship exists and is simply not reasonable to press forward. Obviously as someone who has been in business in the past, it occurs to me that those people who make the loans take that balance as probably one of their central elements of calculus when they decide whether to make a loan or not.

And that being said, do you think that if the Congress clarified the undue hardship provision so that rather than changing—you have got private loans; you have got nonprofit loans; you have got Federal loans. If we had that as a consistent definition in all of them, don't you think that that would be at least a better way to have a consistent lending practice, first of all?

Mr. CUTHBERTSON. Yes, I do, because the considerations that make—that Congress has taken into account to make educational loans non-dischargeable apply equally to Federal loans as to private loans. They are both there to ensure access to higher education and its important public policy the Congress has deemed important and to, you know, to make funds available for students to attain a post-secondary education. So, whether it is a Federal loan or a private loan, they are both serving an important public and societal good.

Now, I do think that if you look at taking away non-dischargeability for private loans you have still got the problems that are alleged with the application of the undue hardship standard for the Federal loans. So I think that I agree with your assessment. We should—Congress should look at, if it is going to do anything, making that standard clear for all loans.

Mr. FRANKS. Well, it occurs to me that if we make bankruptcy—the easier we make bankruptcy, it occurs to me that the more we will have bankruptcy, given that there is pressure on all of us to, you know, to try to discharge our debts if there is an easy way to do it. Now, do you agree with that, just kind of an affirmative or negative?

Do you think that making bankruptcy—this will make bankruptcy easier if we pass legislation doing away with the, you know, the system as it is now? Do you think that this will make bankruptcy easier?

Mr. CUTHBERTSON. Yes, it——

Mr. FRANKS. And do you think that that will increase the incidence of bankruptcy?

Mr. CUTHBERTSON. It would increase the incidence of—well, yes, bankruptcy in—well, in general and the petitions to discharge educational——

Mr. FRANKS. Right. Well, I think it is a, you know, maybe it is just an old-fashioned perspective, but I think it is probably not a good thing for students to start out in life with a bankruptcy on their record, just for their own intellectual standing. It just has a negative effect.

And I do think that you are right, that this will increase bankruptcy, and that can't be a good goal—I don't think it is—because if you increase bankruptcy then you put greater costs on the system. That is inevitable no matter how you face it; somebody has to pay for that.

Now, I know that some of our liberal friends—and I say "friends" and I really do mean that. I know they don't like the word liberal, but some of our friends on the left here can't seem to take—can't seem to understand that you don't have a free lunch. You just, you know, if there is losses that the system has to compensate for that.

So if Congress amends the Bankruptcy Code to allow private student loans to be unconditionally discharged, will anyone other than private lenders have to bear the cost of this change in the law? In other words, will there be ancillary impact in other areas? Will this make it easier to gain student loans in the future?

Mr. CUTHBERTSON. No. I think I agree with what you said. You know, lenders do take loss expectations into account in pricing their loan products, and if there are greater than expected or anticipated losses interest rates will go up, or the credit-granting criteria will be tightened and——

Mr. FRANKS. Wouldn't it be the most naive lender that would not take that into consideration? I mean, you would flunk Banking 101 if you didn't take your loss ratio into consideration.

Mr. CUTHBERTSON. I don't know of any lender that wouldn't take that into consideration.

Mr. FRANKS. Well, I guess, Mr. Chairman, I won't belabor the point here, but I really am convinced that we could deal with the hardship issue effectively. I mean, I am concerned that we might go one way or the other too far. But the idea of making bankruptcy an easy option—and I think this makes it easier—I think not only increases the incidence of bankruptcy, but in the long run it puts additional burdens on the system which, in the final analysis, will mean less money available for student loans and more bankruptcy among our young people.

And unfortunately, I wish there was an easier way to do all of this, but the market sometimes seems to have a wisdom that those of us in government just can't possess no matter how hard we try. And so with that I will yield back.

Mr. COHEN. Thank you.

Since I am the only one here I——

Mr. COHEN. Well, I don't mean that. I just think that the reference to liberal and left, I don't know. I think "liberal" is better than "left." I am not sure, but I don't know where it was directed.

Anyway, Mr. Coble, you are recognized from North Carolina.

Mr. COBLE. I was to Mr. Frank's left.

Mr. COHEN. I noticed that.

Mr. FRANKS. You have lots of ground over there, though.

Mr. COBLE. Good to have the panelists with us.

Mr. Cuthbertson, maybe I am missing something, but I want to extend partially on Mr. Frank's line of questioning. What lender is going to make student loans if the borrower can file Chapter 7 the day after graduation and thereby fully discharge the debt, especially given that the means test, as I understand it, would be a nonissue for someone that is a borrower with no prior or very low levels of employment income? Wouldn't it be hard to find anyone coming forward to make a loan under those conditions?

Mr. CUTHBERTSON. I think that is certainly the concern amongst private sector private loan lenders, yes.

Mr. COBLE. And some of the testimony today is that private student loans are more akin to credit cards than to financial aid. What steps, outside of bankruptcy, can the Congress take to make private student loans more like Federal student loans and less like credit cards? I will start with you, Mr. Cuthbertson.

Mr. CUTHBERTSON. I think, well, Ranking Member Franks mentioned in his opening remarks maybe a more comprehensive reform, if there are abuses in the system, disclosure requirements, regulations that would extend benefit programs to private loans, those types of things would equalize the playing field, I think.

My way of thinking is that if you are going to do a bankruptcy reform it is very limited. If there are true abuses in the system then there are things that maybe Congress could do other than limiting it to taking away the discharge exception in bankruptcy.

Mr. COBLE. Well, that was sort of my thing.

And Professor, let me bring you in on this. To extend the question somewhat, if private student lenders are, in fact, engaged in abusive or misleading lending practices, would we not be better in the Congress to regulate those practices than simply making private student loans dischargeable in bankruptcy?

Mr. PARDO. Well, something has to happen, so the problem with the private student loans is that they don't really offer the same robust avenues for relief from financial distress outside of bankruptcy that Federal loans do, for example, a government loan.

So if you are not going to have those you have to have some sort of social safety net, and currently really the only safety net is bankruptcy, but it is hit or miss with how an undue hardship discharge proceeding comes out.

So student loans borrowers who have private student loans who can only look to bankruptcy for relief, are going to be in a much more difficult situation than borrowers of Federal Government loans.

Mr. COBLE. Mr. Chairman, and I say to the panelists, I am not without compassion, but I have some problems about just willy-nilly discharging debt. That sort of hangs in the craw, Mr. Chairman, and I am not sure that I have any solution.

Anybody else want to be heard on this?

Mr. WEISS. With due respect, that just isn't going to happen. It is not going to happen because the system, as it is currently constituted, would not allow a student immediately upon graduation, and as some of the apocryphal stories went, on the eve of being employed in a high-paying position, to go ahead and discharge their student loans, their bad save issues.

And the judges I practice before, and I suspect the judges that virtually all of my colleagues practice before, would not allow a discharge to occur under those circumstances for the reason if the 2005 act is rolled back, we have the 7-year delay from the date that the loan first became due before it could be discharged in a Chapter 7.

Mr. COBLE. Well, Mr. Weiss, how about the student who is not employed, does not have employment of a high-ranking firm?

Mr. WEISS. Well again, if we go back to the previous law they would not be able to file immediately upon graduation, and I believe one of the reasons why that time period was imposed was to prevent exactly the types of situation that you are referring to.

I don't think anyone at this table, any of the bankruptcy practitioners nationally would believe that it would be appropriate for a student, absent extraordinary circumstances—severe illness, incapacity, et cetera—to be relieved from their obligation to repay their student loans immediately upon graduation.

Mr. COBLE. Thank you, Mr. Weiss.

Let me bring Ms. Asher in before my red light illuminates.

Ms. ASHER. I think it is important to, in addition to the fact that——

Mr. COBLE. It just illuminated, but I guess the Chairman will go along with us.

Ms. ASHER. Is that all right?

Students are actively pursued by credit card companies even though that debt is dischargeable in bankruptcy. I think—again, I am not a bankruptcy lawyer, but "automatically dischargeable" is not really how things work. You still have to prove that you can't afford to pay off your particular debts, and they are subject to some considerable review within the regular bankruptcy process even without the added standard of undue hardship.

But more importantly, there are such major distinctions between private loans as a product—a financial product—and Federal loans that we need to look at them in the context of how we treat other kinds of debt, like credit card debt, like even in extreme cases gambling debt, in thinking about how people approach bankruptcy.

Certainly credit card companies have continued to pursue these very same kinds of students based on assumptions of future earnings, even without being treated in this unique way that private loan companies are.

And in fact, it has taken an act of Congress to help constrain some of the most extreme and abusive marketing practices. I would say in this context there may be things that Congress should consider broadly, beyond this jurisdiction, to reign in some of the most abusive and consumer-unfriendly practices in the private loan industry.

Nevertheless, borrowers of all kinds of debt are in need of that ultimate relief of bankruptcy should they reach those extreme financial circumstances where it is their only alternative.

Mr. COHEN. Thank you.

Thank you, Mr. Coble, who comes from one of the highest, probably, expenses of the public plan in education, University of North Carolina—great school, good public plan.

Professor Pardo, tell me a little more about your study. Did it go into the issues of whether or not a lot of student, when they graduated, used bankruptcy to wipe out this debt?

Mr. PARDO. Well, I will cite two statistics: one, the median age of the debtor in my study was 42 years old; the average age was 45 years old. These are not people who are recent graduates on the eve of lucrative careers who have a lifetime of employment ahead of them. These are folks who have been trying to make a go of it for a long time and they just can't make ends meet, and they are under crushing debt burdens and so they looked to the bankruptcy forum as their avenue for relief.

Mr. COHEN. Before the undue hardship rules—2005 for the private world and maybe I guess it was 1976 for the—was there some large number of folks using the bankruptcy——

Mr. PARDO. Again, this very Congress commissioned a GAO report to delay the effective date of the provision that would make student loans conditionally dischargeable so it could see what had been happening in bankruptcy when they were automatically dischargeable, and the GAO report commissioned by this Congress found that less than 1 percent of all federally matured student loans were discharged in bankruptcy.

Mr. COHEN. And that covered what year, or years?

Mr. PARDO. 1975 and 1976.

Mr. COHEN. Okay. And those were Federal loans?

Mr. PARDO. Yes.

Mr. COHEN. Was there a study on private loans? Was that not an issue?

Mr. PARDO. It wasn't an issue——

Mr. COHEN. They didn't have the undue hardship rule at the time?

Mr. PARDO. There wasn't the undue hardship rule, but the private student loan market really was not at the point it is today.

Mr. COHEN. Well, prior to 2005 when the private loans were—when the undue hardship rules applied there—prior to that were there a lot of private loans that were being bankrupted?

Mr. PARDO. I don't know the answer to that.

Mr. COHEN. Does anybody know the answer to that?

Mr. CUTHBERTSON. I don't know the answer but I think that there probably weren't. I would suspect there weren't because the private loans and the private sector private loans have really taken off in response to the rapidly increasing cost of college education and the caps on the Federal programs. Federal program loans do not cover the entire cost of college education in most instances.

Mr. COHEN. Well, 2 weeks ago—and I don't know if this is really necessarily on point; I think it is, though—we had an economist named Joseph Mason, and he testified before this Subcommittee that by making the discharge of debt in bankruptcy more difficult, the bankruptcy BAPCPA 2005 emboldened leaders to act recklessly in their lending practices, ultimately leading to the onset of the home foreclosure crisis. And he suggested possibly there was some similarity in what might be going on in private student loans.

Do you think that is—do you have any reason to believe he is wrong?

Mr. CUTHBERTSON. I can't really speak to that issue. I don't have any reason to believe he is right or wrong, Chairman. I don't have any information——

Mr. COHEN. Ms. Asher, do you have any thoughts on that?

Ms. ASHER. Yes, I do.

Mr. COHEN. Surprise, surprise.

Ms. ASHER. In 1997 the National Bankruptcy Review Commission, which is a bipartisan commission founded by Congress, determined that there was no evidence to support the assertion that students systematically abused dischargeability in bankruptcy.

As to your question about—forgive me, I have just forgotten the second part of the question. Oh, did lenders make riskier loans after 2005? There is some evidence that the answer is yes. Sallie Mae dramatically increased its portfolio of nontraditional subprime loans during that time, as I mentioned in my oral testimony. It is also spelled out in my written testimony. Finding, not surprisingly, that these very, very high-risk loans turned out to have very high default rates, it then got out of that business in 2008 when there was less access to easy credit and to the securitizations that allowed lenders throughout the economy to make loans to people who they knew couldn't afford them, often under false pretenses, and walk away without having to respond to the risk because they had been sold down the chain.

Mr. COHEN. You mention in your testimony, or maybe in response to a question, something about cosigners—private loans and they can be discharged—or Federal loans, for that matter, but private loans particularly—and they have got a cosigner. Are most of them requiring cosigners now?

Ms. ASHER. Virtually all require cosigners. There are——

Mr. COHEN. And the cosigners—they don't get out in bankruptcies, do they?

Ms. ASHER. They are completely on the hook.

Mr. COHEN. So then how does—so if the student can go ahead and get out of their debt to the lender, which is what this would—Mr. Franks' fears would happen—but the lender still gets their money because they have got this solvent cosigner, Mr. Franks should be happy because the lender is still making money and they have got this cosigner on the hook, and the cosigner can always go after—well, the cosigner might not—they couldn't go after the debtor, or could they later on?

Ms. ASHER. The cosigner is subject to all the same conditions of the contract as the primary signer, and that includes no discharge in the case of death or disability. I know that someone that we work with a lot, Deanne Loonin, who wasn't able to be here today, has a client, a parent who has a child that had a permanent brain injury, and that loan is not dischargeable another—even under that circumstance, while the student's Federal loans were.

Another instance where the parent cosigned—actually, I think in this case it might have been a spouse, and the primary borrower died before he could finish his education. Again, absolutely no relief.

And unfortunately, because of the way these loan contracts are structured, very differently from Federal loans, the borrowers are really at the complete mercy of the private lender in trying to negotiate any kind of accommodation. And when bankruptcy is the only possible relief left, they are left with this very arbitrary and onerous process which is not based on the merits of their case.

Mr. COHEN. Mr. Cuthbertson, what about that? When you have got a cosigner, doesn't that kind of give the lender some solace?

Mr. CUTHBERTSON. Yes, Chairman, I believe it does, and that is probably why they are requiring cosigners, because that makes—you know, that makes the borrowers—makes the repayment of the loan more likely.

Mr. COHEN. Even if the borrower can bankrupt it?

Mr. CUTHBERTSON. Well, yes, because then you have a cosigner who——

Mr. COHEN. So then isn't this all kind of semi-academic, except for the fact that the college students could be left on the hook and, you know, if they want to go bankrupt then they can only go bankrupt for seven—you know, they have got this time limit, they can't do it again, they got it on the record, they got trouble renting an apartment, getting a job, whatever, unless they work for their parents in which case they got an apartment and they got a job. The borrower is, you know, not out at all.

Mr. CUTHBERTSON. Well, the co-obligor, or the cosigner, I think the issue there would come down to how would that present an undue hardship on the cosigner, and that it would be dischargeable or non-dischargeable in bankruptcy to the same extent as it would be by the student.

Mr. COHEN. Right. But don't you think, like, then the cosigner is not going to be—maybe I am missing something here. The cosigner is not going to be discharged in that bankruptcy.

Mr. CUTHBERTSON. Not without showing an undue hardship.

Mr. COHEN. And the borrower just has to get a cosigner that has got some capital, some reserves, which I presume they do anyway. So in reality, there is not going to be a problem. They are going to get a cosigner that is several years older or already making money, got an income stream, got some real property that they can attach, and they are going to be happy.

Mr. CUTHBERTSON. Well, assuming they can do that. I mean, most—you know, most students who are applying for college loans are 18 and are——

Mr. COHEN. Yes, but they are not getting their girlfriend to sign, or their boyfriend. I mean, they are getting some older type that is willing to help them get through life.

Mr. CUTHBERTSON. Right.

Mr. COHEN. Mr. Weiss, is this kind of maybe—isn't the cosigner the answer to the problem?

Mr. WEISS. Yes and no. You are absolutely correct that if the borrower files for bankruptcy and is discharged then the lender can go after the guarantors and, you know, when I applied—when my daughter applied for a student loan they needed a guarantor and, you know, that was me. So I am very familiar with that process.

One issue that has been spoken about is that people would view bankruptcy as an easy option and sort of willy-nilly, oh, what the heck, I will go ahead and file for bankruptcy. That is so far from reality, with due respect, that it is just absolutely dead wrong.

The people who come to see me to file for bankruptcy would rather have a root canal without anesthesia than talk to a bankruptcy lawyer. They are embarrassed; they are ashamed; they have been trying for years to live up to their obligations and pay their bills, and they only come to see me when they are completely incapable of doing that.

Student loans are not the primary factor for bankruptcy. Student loans are sort of in the mix for a client who has been ill, or had job loss, or their business went down the tubes, largely due to factors outside of their control. People very, very rarely—and the data justifies this—file for bankruptcy because of a student loan. It is merely one debt that is in the mix.

Mr. COHEN. I would like to yield to my Ranking Member, who maybe has seen the red light.

Mr. FRANKS. Thank you, Mr. Chairman.

Ostensibly, when we began this hearing, this was about, at least to some degree, how to make it easier on students. In other words, we were trying to assist students here. And even though I made the case as best I could that I believe in the long run this will hurt a larger number of students—it might help some in a challenging situation now, but I think it will be to the detriment of a larger number of students. That is my personal opinion.

But now I hear about the cosigners. Sure sounds like we are all of a sudden now encouraging an entire class of people to take bankruptcy. And I am not sure that that is good for the system either.

If we make it—the more we make—the easier we make bankruptcy—I agree with Mr. Cuthbertson's statement: The easier that we make bankruptcy—and again, ask whether it is the right thing or not—but the easier we make it, I think the more we increase the chances of the loans not being paid back. And if we increase the default rate, if we increase loans not being paid back, that money has to go—I mean, has to come from somewhere, and I believe that that will decrease the available amount of capital for loans.

Now, you know, we talked about credit cards. Sometimes maybe somebody takes out bankruptcy for credit cards might have maybe four or five credit cards, $5,000, $6,000 a piece because there is a certain cap on credit card lending. But as Mr. Weiss pointed out, you know, some of the college education is now around $200,000. Well, that is not far from the median price of a house.

And, you know, if we expect people to make these high-risk loans of up to, you know $100,000 or $200,000, for a very good purpose, which is to help our young people get education, but if we expect the money to be there for them, if that is our purpose, then the more we weaken the system by which they can make some type of common sense calculation, or at least have some confidence that they are going to be repaid, the less they are going to do that. It is fundamentally simple. I wish it weren't.

I wish there was some way to turn lead into gold. I really do. But unfortunately, reality will prevail in this situation, as it always has.

You mentioned, Ms. Asher, related to the—what did you call it the Sallie Mae—where a lot of the loans that were made were not really very sound loans. Well, now, you know, there was an awful lot of pressure on people to make loans that weren't sound, and did that help the people who got the loans? Probably not. Didn't help them much because those loans weren't sound and they ended up getting in trouble anyway. And did that hurt everybody else? Yes, I think it did.

If you apply it to the mortgage industry it was the central element of the entire economic meltdown. It is okay to blame Wall Street for some of the bad things they did; they did a lot of bad things. But they essentially took loans that were rated a certain way and repackaged them and sold them off—and I think there is some big problems with that—but they took these loans and they repackaged them.

If the loans had performed as those who rated the loans said they would, all of the problems could have fundamentally been eradicated. There wouldn't have been a meltdown if the loans had performed but they didn't.

And I think that we have to realize that there are about three or four factors that give us the best chance of seeing loans perform. One is, people have to be able to make a calculation saying, "Okay, this person, they don't have a job right now," or whatever, they have to make a calculation on the person's ability to repay the loan, with cosigner's help or not. Secondly, they have to make a calculation whether or not the loan can be profitable to them to make it at a certain interest rate.

And all of these calculations have to be in place before they make the loan, before any of it happens. And if we tinker with the Bankruptcy Code in ways that will weaken that system—I know there is a balance, but if we tinker with ways that will weaken the system I think we will hurt students in the long run.

And fundamentally I am hoping—and I am going to let this be my last word to the Chairman—I am hoping that we can do something to define undue hardship in a way that is in comportment with both of our values and with common mathematical sense that a businessman or a business individual can make an empirical calculation on so that they can make these loans.

I think we will be hurting the student loan program in the long run or allowing government—or forcing government, as it were—to supplant that, which, in the long run, the way things are going, someday won't be there and there will be a day of reckoning that will hurt an awful lot of people in a big way.

And I think we will all be the worse for it, and that example has been repeated throughout history. The highway of history is littered with the wreckage of systems that thought government could come in and run it better than the private market based on common sense principles.

And with that, Mr. Chairman, I yield right at the light.

Mr. COHEN. Thank you, Ranking Member. We appreciate your apocalyptical analysis. Yes——

Mr. FRANKS. I have never heard of that word.

Mr. COHEN. Yes, well I might have made that one up. I don't know.

Apocalypse not—apocalyptical. That is it. I left out a consonant.

But I appreciate all the testimony and we appreciate Chairman George Miller, who couldn't be with us today, who endorses the hearings and thanked us for having these hearings and thinks it is important that we get into this issue.

We are going to look into doing some legislation. As I said, I would appreciate each of the Members here submitting to us how they think we can define undue hardship to make it a level playing field on all the jurisdictions and also any other suggestions they have got for the legislation——

Mr. FRANKS. Mr. Chairman, with your permission I would like to put this statement for the record: Education Finance Council on the record, September 23, 2009.

Mr. COHEN. Without objection.

Mr. FRANKS. Thank you, sir.

Mr. COHEN. So done.

So with that, I would like to thank all the witnesses for their testimony today. Without objection Members will have 5 legislative days to submit any additional written questions, which we will forward to the witnesses and ask that you answer them as promptly as possible to be made part of the record. Without objection the record will remain open for 5 legislative days for the submission of any other additional materials.

[Whereupon, at 3:21 p.m., the Subcommittee was adjourned.]

APPENDIX

Material Submitted for the Hearing Record

Material submitted by the Honorable Trent Franks, a Representative in Congress from the State of Arizona, Member, Committee on the Judiciary, and Ranking Member, Subcommittee on Commercial and Administrative Law

EFC
EDUCATION FINANCE COUNCIL

Hearing on an Undue Hardship? Discharging Educational Debt in Bankruptcy

Statement for the Record
Education Finance Council

September 23, 2009
House Judiciary Committee
Subcommittee on Commercial and Administrative Law

The Education Finance Council (EFC) is the national trade association representing the Nation's non-profit and state-based student loan providers. These public purpose organizations are dedicated to the single goal of making college more affordable. For decades, the financial aid products and services they offer have provided millions of students access to higher education.

Nonprofit loan providers work with students and schools to ensure that students borrow only the amount needed and exhaust their federal borrowing limits before they consider taking out non-federally guaranteed (or "private") loans. Moreover, the private loans offered by nonprofit and state-based lenders are often fixed rate, and frequently feature more attractive terms than the borrower would receive from other financial institutions. Importantly, any revenue that nonprofit loan providers do generate on these loans is used to further their public purpose mission by, e.g., supporting outreach and financial literacy programs for students and their families, particularly targeting under-served and under-represented populations.

Education loans made by nonprofits have for decades been non-dischargeable in bankruptcy. Since the enactment of the 1978 Bankruptcy Code, loans made by nonprofit institutions of higher education have been non-dischargeable unless debtors could prove that the loans would impose an undue hardship on them and their dependents (see e.g, 11 U.S.C. 553(a)(8)). In 1984, the Bankruptcy Amendments and Federal Judgeship Act extended this non-dischargeability to all non-profit lenders. More recently, in 2005, as a part of a major rewrite of the Bankruptcy Code, Congress expanded the protections against dischargeability to all lenders making private education loans -- regardless of the type or tax-status of the entity making or guaranteeing those loans.

Particularly in difficult economic times, protection against dischargeability reduces the risk of principal loss, thus lowering the cost of financing loans. This reduces the interest rates charged to borrowers. If non-dischargeability were revoked, it would raise lenders' financing costs and require them to set-aside greater capital reserves. Rating agencies recognize the importance of non-dischargeability in mitigating the riskiness of private student loan financings. For example, Fitch Ratings stated that when calculating certain collateral considerations for its rating, that it "assumes that the loss and recovery performance for private student loans will continue to reflect [nondischargeability] in the future (*U.S. Private Student Loan ABS Criteria*, Fitch Ratings, August 24, 2009).

Eliminating non-dischargeability protection would force non-profit lenders offering private loans to adjust their offerings by either raising borrower rates, elevating underwriting standards, or both. This would reduce the higher education options available to many students.

While signs of improvements in the credit markets are welcome, the climate for financing student loans, particularly non-federally guaranteed loans, remains challenging. Non-profit and state-based student lenders remain committed to expanding access to higher education. An erosion of dischargeability protections on the loans nonprofit student loan providers finance, however, would further jeopardize their ability to offer private student loans to those borrowers who are unable to afford their cost of education using the federal student aid programs alone.

ANSWERS TO POST-HEARING QUESTIONS FROM LAUREN ASHER,
THE INSTITUTE FOR COLLEGE ACCESS AND SUCCESS

Questions for the Record
Subcommittee on Commercial and Administrative Law
Hearing on an "Undue Hardship? Discharging Educational Debt in Bankruptcy"
September 23, 2009

Responses submitted January 22, 2010

Lauren Asher, The Institute for College Access and Success

Questions from the Honorable Steve Cohen, Chairman

1. **In your written testimony, you indicated that you have found "nearly two-thirds of undergraduates who borrowed private loans in 2007-08 had not exhausted their main federal borrowing option that year." To what do you attribute that trend, and what do you believe the solution to that problem might be? Does Congress have a role to play in that solution?**

This is an excellent question. Due to the scant data available on private student loan borrowing, it is difficult to provide a comprehensive answer. However, we have identified several factors that at least partially explain why so many students are turning to private loans before maximizing their federal loan options. These factors point to a range of steps Congress and the Administration could take to minimize reliance on risky and costly private student loans.

Simplify the federal financial aid process
Fourteen percent of private loan borrowers do not fill out the Free Application for Federal Student Aid, or FAFSA, which is necessary to receive any federal student aid as well as most other types of aid. Despite some important recent improvements to the online version, the FAFSA is still too complex and intimidating, and it requires a great deal of personal and family financial information that can be especially difficult for low-income students to track down.

Private loans do not require completion of the FAFSA, and lenders have used this as a selling point in their marketing. Simplifying the federal aid application process would help increase the number of students who complete the FAFSA and take out federal loans instead of private loans. It may also reduce some students' need to borrow if they are eligible for federal, state, and/or institutional grant aid.

The Higher Education Opportunity Act of 2008 (HEOA) encourages and empowers the U.S. Department of Education to simplify the FAFSA by letting applicants pre-populate the form with their own tax data, as we have proposed.[1] Later this month, the Department plans to begin a pilot test that will allow some students to import their IRS data directly into their FAFSA. We would like this option to be made available to all students as soon as possible. The House-passed Student Aid and Financial Responsibility Act (H.R. 3221) would made additional changes to further simplify the FAFSA.

[1] See, for example, our 2007 report, *Going to the Source: a Practical Way to Simplify the FAFSA*, at http://www.ticas.org/program_view.php?idx=7.

Improve information and counselling

Many students do not realize they could borrow federal student loans, because they incorrectly believe there are income limits on eligibility. Others do not understand key differences between federal and private student loans and may think a variable-rate private loan is cheaper because of an advertised low starting rate. Still others may not realize they are being offered something other than a federal loan. For instance, a school may offer a student a financial aid package containing a Sallie Mae Stafford Loan and a Sallie Mae Smart Option Loan, without clarifying that one is federal and the other is not.

The HEOA required improved lender disclosures, which will go into effect in February 2010, and prohibited certain conflicts of interest between schools and lenders that led some schools to promote private loans over federal loans. In addition, the House-passed Wall Street Reform and Consumer Protection Act (H.R. 4173) would require lenders to have schools "certify" private loans before the loans are disbursed. This means lenders would have to contact the prospective borrower's school to confirm the borrower is in fact enrolled and eligible to borrow the loan amount. The legislation would also require schools to inform students of any remaining federal loan eligibility before certifying the loan. This school certification and counseling should significantly reduce private loan borrowing as well as the amounts borrowed.

Reduce the delay in disbursing federal aid

Because of federal laws and regulations and school practices, it can take weeks for students to receive their federal grants or loans. Private lenders often exploit this delay, emphasizing in their marketing that private loans can be approved and disbursed immediately. Changes to the federal student aid disbursement and verification regulations are currently being negotiated and have the potential to speed the delivery of federal student aid. The school certification and counseling provisions in H.R. 4173 would also give more students the time and opportunity to consider their federal borrowing options before being rushed into a private loan.

Improve the loan information in financial aid award letters

Our review of financial aid award letters revealed that they commonly fail to mention the availability of unsubsidized federal student loans or how much the student is eligible to borrow. Students receiving such letters could incorrectly believe that they do not have any additional federal borrowing options and seek out private loans. We have submitted detailed recommendations to the Department to help improve school award letters, and Congressional interest would be welcome.

Increase the data available about private loans

Policymakers, researchers, and colleges all need more and better information about private loans to further reduce unnecessary private loan borrowing. Currently, the best available data are from a federal survey conducted only once every four years, the National Postsecondary Student Aid Study (NPSAS). These data cannot be broken down by school or, with just a few exceptions, by state. Improving federal data collection and dissemination would provide needed answers to important questions about who borrows private loans, why, where they go to college, and how much they are borrowing in private and federal loans, separately and combined. Federal legislation is necessary to require that private loan data is collected and that falls under the jurisdiction of the House Financial Services Committee.

2. If there are any additional points you wish to make—by way of elaborating upon your hearing testimony or responding to the testimony of other witnesses—please do so.

Please include in the hearing record the September 23, 2009 letter below from 18 groups representing students, consumers, institutions of higher education and public policy organizations urging Congress to end the unfair special bankruptcy treatment for lenders who saddle students and their families with high-risk, high-cost private student loans. Thank you.

September 23, 2009

The Honorable Steve Cohen
Chairman, Subcommittee on Commercial and Administrative Law
Committee on the Judiciary
U.S. House of Representatives
Washington, DC 20515

Dear Chairman Cohen:

On behalf of the undersigned organizations, we thank you for convening the House Committee on the Judiciary Subcommittee on Commercial and Administrative Law for a hearing entitled "An Undue Hardship? Discharging Educational Debt in Bankruptcy." We understand that this is the first Congressional hearing to focus on issues related to the non-dischargeability of private (non-federal) student loans.

Private student loans are one of the riskiest, most expensive ways to pay for college. Like credit cards, they have variable interest rates that are often higher for those who can least afford them. However, unlike credit cards, private student loans are nearly impossible to discharge in bankruptcy. Further, private student loan borrowers are not eligible for the important deferment, income-based repayment, or loan forgiveness options that come with federal student loans. They generally have no right to assistance if they face unemployment, disability, financial distress, or even a school that closes its doors leaving them without the ability to complete their degree.

Our broad coalition of groups representing students, consumers, institutions of higher education and public policy organizations urge Congress to end the unfair special bankruptcy treatment for lenders who saddle students and their families with high-risk, high-cost private student loans. Thank you for your bringing attention to this important and urgent issue.

Signed,

American Association of Collegiate Registrars and Admissions Officers
American Association of Community Colleges
American Association of State Colleges and Universities

American Council on Education
Association of Jesuit Colleges and Universities
American Federation of Teachers
Campus Progress Action
Consumer Action
Consumers Union
Dēmos: A Network for Ideas & Action
National Association of College Admissions Counseling
National Association of Consumer Bankruptcy Attorneys
National Consumer Law Center (on behalf of our low-income clients)
National Education Association
Project on Student Debt
U.S. Public Interest Research Group
United States Student Association
USAction

ANSWERS TO POST-HEARING QUESTIONS FROM RAFAEL I. PARDO, SEATTLE UNIVERSITY SCHOOL OF LAW

Questions for the Record
Subcommittee on Commercial and Administrative Law
Hearing on an "Undue Hardship? Discharging Educational Debt in Bankruptcy"
September 23, 2009

Rafael I. Pardo, Seattle University School of Law

Questions from the Honorable Steve Cohen, Chairman

1. **If Congress were to eliminate the "undue hardship" requirement for private student loan debtors, making such loans automatically dischargeable, should a waiting period for discharging such debt be included? If so, what would be an appropriate waiting period?**

If Congress were to eliminate the "undue hardship" requirement for discharging private student loans in bankruptcy, a waiting period for discharging such debt should not be imposed on a debtor. Presumably, the rationale for imposing a waiting period would be to safeguard the fiscal solvency of the private-student-loan market as well as to prevent abuse of the bankruptcy system. The following excerpt from one of my co-authored studies on the discharge of student loans in bankruptcy, while not directly on point, provides analogous support for the conclusion that a waiting period would be unnecessary and thus inappropriate:

> Thus far, we have seen that, from the moment policymakers conceived that student loans should be conditionally excepted from the scope of discharge in bankruptcy, perceived rather than real abuse gripped their consciences. Congress's special treatment of educational debt, based on anecdotal evidence rather than empirical data, has resulted in the uneasy marriage of two disparate policies that some have deemed to be related: (1) preserving the financial solvency of the student aid system and (2) preventing abuse of the bankruptcy system. In our view, however, the Bankruptcy Code's educational debt provision is ineffective and unnecessary to meet the first policy objective and is unsuitable to meet the second. We conclude that, although the statute is poorly designed, courts need not cloud analysis of a debtor's claim of undue hardship with such policy considerations.
>
> While the abusive discharge of educational debt would impact to some extent the financial solvency of the student loan program, threats to the program's viability exist independently and are of concern outside of bankruptcy. For those individuals who default on their educational debt obligations, but who do not avail themselves of bankruptcy relief, the resulting nonrepayment will still pose a threat to the viability of such programs. Accordingly, since it has never been shown that the discharge of educational debt in bankruptcy threatened to collapse the student loan

system, any legislative history references to the policy objective of protecting the financial integrity of that system should not inform application of the undue hardship standard. We think this especially to be the case now that Congress has amended the Bankruptcy Code to except from discharge educational loans made by *for-profit* entities.

Similarly, concern over abuse of the bankruptcy system by student loan debtors should not define the contours of what is meant by the term "undue hardship." The concern over debtor abuse can be explained in part by reference to the economic principles of private information and moral hazard. As a general matter, a debtor who borrows money from a creditor knows (1) whether or not he intends to repay the debt, and (2) what circumstances exist or may come into being that reduce the likelihood of repayment. To some extent, the creditor may be able to obtain information by asking the debtor or by looking for indicators that payment will be forthcoming from the debtor (e.g., a credit report). To the extent that the debtor's intentions cannot be (or are too costly to be) unearthed by the creditor, that knowledge is private information unavailable to the creditor. In a legal regime that discharges debtors from personal liability for past debts, private information creates a moral hazard. A debtor who knows that he can obtain a discharge has an incentive to obtain the extension of credit, use the credit, default on his repayment obligation, and ultimately file for bankruptcy to discharge the debt. This precise situation prompted Representative Ertel to argue for a provision in the Bankruptcy Code that would preserve the conditionally dischargeable status of educational debt.

Two reasons occur to us why moral hazard should be deemed an inappropriate justification for the conditionally dischargeable status of educational debt. First, past empirical evidence did not indicate systemic manipulation by debtors of the legal opportunity to discharge their student loans when bankruptcy law allowed for their automatic discharge. Second, and above all else, the Code has already created safeguards against such abusive and opportunistic behavior on a general basis. These safeguards can adequately respond to moral hazard in the educational debt context. First, the Code excepts from discharge a debt for money to the extent that it was obtained by false pretenses, a false representation or actual fraud. Thus, where a debtor obtains a student loan intending to seek a discharge prior to or shortly after completing his education and the creditor justifiably relied on the representation of the debtor that repayment would be forthcoming, a court should find the educational debt to be nondischargeable—not on the basis of undue hardship, but rather on the basis that the debtor either (a) intentionally made a false representation of his intent to repay the debt, or (b) recklessly made the representation of his intent to repay the debt. Such a determination would be made irrespective of the *amount* of credit extended to the debtor. Thus, it is inappropriate to incorporate a judicially implied rule that accounts for debtor fraud into the standard for undue hardship when the Code already provides an adequate statutory remedy to address this situation.

> But what of the situation where the creditor did not justifiably rely on the false representation of the debtor? Does the Code safeguard against moral hazard? In the case of a Chapter 7 debtor whose debts are primarily consumer debts, the bankruptcy court may dismiss the case on the basis that the granting of relief would constitute an "abuse" of the provisions of Chapter 7. Under certain circumstances, the provision would ostensibly safeguard against the debtor whose motive for filing for bankruptcy was to discharge primarily educational debt. The definition of a "consumer debt" includes any debt incurred by an individual primarily for a personal purpose. Were a court to characterize the educational debt incurred by a debtor as consumer debt, a debtor whose debts consisted predominantly of educational debt would not be eligible for bankruptcy relief in the first instance, so long as the court concluded that the granting of relief would constitute an abuse.
>
> . . . In light of these considerations, we believe courts must abandon their adherence to incoherent policy objectives in their analysis of the law—an adherence that has allowed the unsubstantiated myth of the abusive student loan debtor to persist.

Rafael I. Pardo & Michelle R. Lacey, *Undue Hardship in the Bankruptcy Courts: An Empirical Assessment of the Discharge of Educational Debt*, 74 UNIVERSITY OF CINCINNATI LAW REVIEW 405, 428-32 (2005) (footnotes omitted).

2. **If there are any additional points you wish to make—by way of elaborating upon your hearing testimony or responding to the testimony of other witnesses—please do so.**

I would like to elaborate on my hearing testimony by providing suggested revisions to the Bankruptcy Code's student-loan discharge provision (i.e., 11 U.S.C. §523(a)(8)). In the revisions which appear below: (1) deleted material is stricken; (2) new material is italicized; and (3) where new punctuation stands alone and is unaccompanied by new text, it is underlined.

Proposed Revision to 11 U.S.C. § 523(a)(8):

§ 523. Exceptions to discharge.

(a) A discharge under section 727, 1141, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt—

. . .

(8) unless excepting such debt from discharge under this paragraph would impose an undue hardship on the debtor and the debtor's dependents, for—

(A) (i) an educational benefit overpayment or loan made, insured, or guaranteed by a governmental unit, or made under any program funded in whole or in part by a governmental unit or nonprofit institution; or

(ii) an obligation to repay funds received as an educational benefit, scholarship or stipend.~~; or~~

(B) ~~any other educational loan that is a qualified education loan, as defined in section 221(d)(1) of the Internal Revenue Code of 1986, incurred by a debtor who is an individual;~~

(i) It shall be presumed that excepting such debt from discharge under this paragraph will impose an undue hardship on the debtor and the debtor's dependents to the extent that the debtor's average monthly income less the debtor's average monthly expenses (exclusive of any payment on such debt), as shown on the debtor's schedule of current income and current expenditures required by section 521(a)(1)(B)(ii), is less than the average monthly payment scheduled on such debt. If the repayment period for such debt has been suspended, the average monthly payment on account of such debt shall be calculated exclusive of the suspension period. If the debtor is enrolled in an income-based or income-contingent repayment program or plan to repay such debt, the average monthly payment on account of such debt shall be calculated as the total amount of such debt divided by the number of months remaining in such program or plan.

(ii) (I) The presumption of undue hardship may be rebutted only if the party opposing the discharge of such debt establishes by clear and convincing evidence the

existence of special circumstances that justify an increase in the debtor's monthly income or a reduction in the debtor's monthly expenses. A debtor's eligibility for or enrollment in an income-based or income-contingent repayment program or plan to repay such debt does not constitute a special circumstance.

(II) The presumption of undue hardship will be rebutted only to the extent that the special circumstances referred to in section 523(a)(8)(B)(ii)(I) cause the debtor's average monthly income less the debtor's average monthly expenses (exclusive of any payments on such debt) to exceed such expenses.

(C) If payment on such debt first became due less than five years (exclusive of any applicable suspension of the repayment period) before the date of the filing of the petition, subparagraph (B) shall not apply.

(D) (i) After notice and a hearing, on motion by the debtor or by the creditor to whom such debt is owed, the court shall discharge such debt to the extent it imposes an undue hardship on the debtor and the debtor's dependents.

(ii) For a discharge determination where the presumption of undue hardship arises and is not fully rebutted, the court shall discharge, at a minimum, an amount of such debt equal to the amount calculated by (1) subtracting the amount determined under section 523(a)(B)(ii)(II) from the amount determined under section 523(a)(8)(B)(i) and (2) multiplying the difference by the number of months remaining in the repayment period for such debt.

ANSWERS TO POST-HEARING QUESTIONS FROM BRETT WEISS, JOSEPH, GREENWALD & LAAKE, P.A.

Questions for the Record
Subcommittee on Commercial and Administrative Law
Hearing on an "Undue Hardship? Discharging Educational Debt in Bankruptcy"
September 23, 2009

Brett Weiss, Joseph Greenwald & Laake, PA

Questions from the Honorable Steve Cohen, Chairman

1. **What is your view of Professor Pardo's suggestion that Congress should clarify the "undue hardship" standard by creating a presumption of undue hardship for debtors who lack sufficient disposable income to repay their student loans?**

   Response: NACBA's view is that such a standard represents only a minor improvement over the current situation. Even under this standard, there would be an adversary proceeding that a debtor cannot afford to pursue, and as a result, it would be of very limited value. And there still would be disputes about how much disposable income debtors have, so at best it represents a minor improvement regarding what debtors must prove.

2. **If Congress were to eliminate the "undue hardship" requirement for private student loan debtors, making such loans automatically dischargeable, should a waiting period for discharging such debt be included? If so, what would be an appropriate waiting period?**

   Response: NACBA's position is that there should not be any waiting period. Private student loans are no different than other debts granted based upon a debtor's credit history. They are thus dramatically different than student loans granted without regard to a young person's credit.

3. **If there are any additional points you wish to make—by way of elaborating upon your hearing testimony or responding to the testimony of other witnesses—please do so.**

PREPARED STATEMENT OF THE AMERICAN ASSOCIATION OF COLLEGIATE REGISTRARS AND ADMISSIONS OFFICERS (AACRAO), THE AMERICAN ASSOCIATION OF STATE COLLEGES AND UNIVERSITIES (AASCU), AND THE NATIONAL ASSOCIATION FOR COLLEGE ADMISSION COUNSELING (NACAC)

U.S. House of Representatives

Committee on the Judiciary

Subcommittee on Commercial and Administrative Law

Hearing on Undue Hardship: Discharging Educational Debt in Bankruptcy

Wednesday, September 23, 2009

Statement by

American Association of Collegiate Registrars and Admissions Officers (AACRAO)

American Association of State Colleges and Universities (AASCU)

National Association for College Admission Counseling (NACAC)

Mr. Chairman and members of the Subcommittee,

The undersigned organizations, representing institutions of higher education, are pleased to provide written testimony on treatment of private educational loans in bankruptcy. Our members have long been committed to promoting institutional integrity and protecting students, and we submit this testimony to voice their concerns about the manner in which the peculiar treatment of "educational loans" is undermining both of these important priorities.

As the members of the subcommittee are well aware, bankruptcy law has restricted the ability of borrowers to discharge their federal student loans since the mid-1970s. For more than a decade, federal student loans have been non-dischargeable altogether, except for cases of undue hardship. While this exceptional treatment of federal student loans under bankruptcy law is harsh, federal student loans do provide basic consumer protections, their own specific discharge provisions, and flexible repayment options that serve as meaningful alternatives to bankruptcy discharge for borrowers. The undersigned, therefore, seek no change to the treatment of federal student loans in bankruptcy.

Our concerns focus on the treatment of private educational loans in bankruptcy. Beginning in the early 1990s, for reasons that were never articulated or debated, Congress began to extend the bankruptcy code's exceptionally harsh treatment of federal loans to private educational loans. Until the 2005 bankruptcy reform act, this identical treatment was limited to private loans that were funded or guaranteed by states or non-profits. This ill-advised expansion rendered a large number of non-federal loans non-dischargeable in bankruptcy, even if they had none of the important attributes that justified that treatment for federal loans.

In making this change, Congress appears to have assumed that states and non-profits would voluntarily configure their educational loan offerings in a manner that would eliminate the need for bankruptcy discharge for their borrowers. It should come as no surprise to any observer of the student lending industry that the exact opposite occurred. Non-dischargeability of educational loans provided eligible lenders with a carte-blanche to impose ever harsher conditions on borrowers. Many of these borrowers were unaware that unlike with federal loans, the promissory notes they were signing would obligate them to repay the loans even in cases of school fraud, school closure, or total and permanent disability.

The primary benefit to eligible issuers of these loans was that the bankruptcy code's unorthodox treatment of their loans insulated them from the economic consequences of otherwise untenable lending practices. Predictably, these lenders were at the forefront of predatory educational lending practices, and began to provide high-dollar private-label loans to borrowers without much concern about the latter's ability to repay the loans. Low-income students, particularly those attending expensive for-profit career schools, were targeted through collaborative marketing and origination relationships between

schools and lenders, who in some cases jointly forecasted future default rates of more than 50 percent on the sub-prime loans that they aggressively promoted.
The comparative advantage that the "non-profit" issuers of such private-label loans enjoyed was quickly seized upon by other predatory providers, who sought a similar advantage for their products. In 2005, again without hearings or debate, Congress extended the exceptional bankruptcy treatment initially afforded only to federal loans to all educational loans. That unfortunate change, in turn, led to an explosion in sub-prime educational lending practices, which this ill-thought-through federal incentive unwittingly facilitated. Predatory lending targeting low-income and minority communities expanded, while an entire new line of "direct-to-consumer" programs targeted middle- and upper-middle-income families with easy, but punitively harsh educational credit offerings. The most salient feature of these programs is that their issuers were substantially shielded from the consequences of their high-risk products by the fact that borrowers could not discharge these predictably unaffordable loans even in bankruptcy, and that the promissory notes were really a modern indenture instrument.

In addition to its fundamentally negative consequences of promoting irresponsible lending practices, the vagueness and imprecision of the actual language of the 2005 amendment has created loopholes for additional fraudulent and abusive practices. For example, the statutory language fails to define the "educational loans" that it excludes from eligibility for ordinary bankruptcy discharge. This lack of precision allows virtually any credit transaction with families with students in school to be arguably non-dischargeable. This same imprecision makes it impossible to track and analyze the scale and scope of the private-label educational loan market, since institutions may well be entirely unaware of credit that might be marketed to their students and their families. This same lack of institutional awareness makes it quite likely that families and students may be induced to borrow more than their actual unmet need.

Mr. Chairman, the subcommittee's hearings today are a very important first step in documenting and addressing the problems associated with the highly unorthodox special treatment that Congress opted to extend to private educational loans. As stated above, the unconditional extension of non-dischargeability to private loans has created a perverse incentive for risky lending practices that victimize borrowers and reward the most irresponsible lenders at the expense of other creditors. This fundamental distortion of the bankruptcy code also rewards shoddy schools by enabling them to arrange for inappropriately large private-label loans for their students through collusion with sub-prime lenders. We find it particularly offensive that entities profiting from these predatory practices justify their special treatment in the bankruptcy code by claiming that non-dischargeability lowers the cost of all private educational loans. There is no evidence that the enactment of the 2005 changes lowered the cost of loans, and therefore, no reason to believe that its repeal would increase the cost.

Legitimate private educational loan programs are subject to underwriting criteria to ensure reasonable prospect of repayment. Bankruptcy, let alone dischargeability in bankruptcy, is not even remotely probable factors for such programs. As previously stated, we believe that non-dischargeability of loans has facilitated the marketing of subprime loans to more vulnerable populations, and that their unorthodox treatment has served as a powerful incentive to promote over-borrowing. We urge the subcommittee to examine a complete exclusion of private educational loans from the special bankruptcy treatment previously reserved only for federal loans.

Mr. Chairman, we thank you for your leadership on this important issue, and stand ready to work with you and your colleagues as you act on the findings of today's hearing.

LETTER TO THE HONORABLE STEVE COHEN, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF TENNESSEE, AND CHAIRMAN, SUBCOMMITTEE ON COMMERCIAL AND ADMINISTRATIVE LAW, FROM RICHARD WILLIAMS, USPIRG HIGHER EDUCATION ASSOCIATE

U.S. PIRG
Federation of State PIRGs

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The Honorable Chairman Steve Cohen
Subcommittee on Commercial and Administrative Law
2138 Rayburn House Office Building
Washington, DC 20515

October 1, 2009

Dear Chairman Cohen,

U.S. PIRG is the federation of state Public Interest Research Groups-- nonpartisan, non-profit public interest advocacy organizations based in 30 states. We work with students on more than 100 college campuses across the country. On behalf of those hundreds of thousands of college students, USPIRG works to promote an affordable and accessible higher education.

On September 23, 2009, the subcommittee held a hearing entitled "An Undue Hardship? Discharging Educational Debt in Bankruptcy" to examine the lack of bankruptcy protection afforded borrowers who take on private, unsubsidized student loans to pay for college. Please accept this letter to the public record in support of providing bankruptcy protection to private student loan borrowers.

The social and economic health of the country relies on the number of students graduating from college, but as college budgets are cut at the state level, college costs to students are soaring. Students and their families have turned to loans to finance a college education. Young people, who generally have little or no credit history and no equity, receive unfavorable treatment in the traditional credit market. Four decades ago, Congress created the subsidized student loan programs to provide capital to students regardless of their income and credit. Currently, federal student loans are a crucial part of the college financing equation; 62% of all graduates from four year public colleges carry federal loan debt upon graduation. On average, they carry over $20,000 in federal loan debt; students may borrow up to $31,000 in federal student loans.

Unfortunately, as the average amount of federal loan debt climbs, so do the numbers of students taking out more than the average in debt to pay for college. According to the Project on Student Debt, 15% of students are borrowing private loans, yet 64% of these students never maximize the federal aid available to them. These students are taking out riskier, higher priced, private loans to finance their degrees, which can carry an interest rate at 20% *or higher* and offer minimal benefits and inflexible repayment options for borrowers.

In general, private student loans are a costly option for all borrowers and especially costly for low-income students, the very population our federal aid programs are designed to help.

Adding insult to injury, private student loan borrowers are treated more harshly than consumers who carry any other form of debt in that they are denied the right to declare bankruptcy if they simply cannot repay. Student loan borrowers who encounter unforeseen life circumstances later in life, such as a debilitating illness or injury that can keep them from working, must still continue to find a way to repay their loans. People who borrow to pay for college, and are subject to the high costs and harsh terms of private student loans, deserve fair treatment, especially given the societal value of higher education.

Don't hesitate to contact me with further questions.

Sincerely,

Richard Williams
USPIRG Higher Education Associate

LETTER TO THE HONORABLE STEVE COHEN, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF TENNESSEE, AND CHAIRMAN, SUBCOMMITTEE ON COMMERCIAL AND ADMINISTRATIVE LAW, FROM A COALITION OF GROUPS IN SUPPORT OF THE ISSUE

September 23, 2009

The Honorable Steve Cohen
Chairman, Subcommittee on Commercial and Administrative Law
Committee on the Judiciary
U.S. House of Representatives
Washington, DC 20515

Dear Chairman Cohen:

On behalf of the undersigned organizations, we thank you for convening the House Committee on the Judiciary Subcommittee on Commercial and Administrative Law for a hearing entitled "An Undue Hardship? Discharging Educational Debt in Bankruptcy." We understand that this is the first Congressional hearing to focus on issues related to the non-dischargeability of private (non-federal) student loans.

Private student loans are one of the riskiest, most expensive ways to pay for college. Like credit cards, they have variable interest rates that are often higher for those who can least afford them. However, unlike credit cards, private student loans are nearly impossible to discharge in bankruptcy. Further, private student loan borrowers are not eligible for the important deferment, income-based repayment, or loan forgiveness options that come with federal student loans. They generally have no right to assistance if they face unemployment, disability, financial distress, or even a school that closes its doors leaving them without the ability to complete their degree.

Our broad coalition of groups representing students, consumers, institutions of higher education and public policy organizations urge Congress to end the unfair special bankruptcy treatment for lenders who saddle students and their families with high-risk, high-cost private student loans. Thank you for your bringing attention to this important and urgent issue.

Signed,

American Association of Collegiate Registrars and Admissions Officers
American Association of Community Colleges
American Association of State Colleges and Universities
American Council on Education
Association of Jesuit Colleges and Universities
American Federation of Teachers
Campus Progress Action
Consumer Action
Consumers Union
Dēmos: A Network for Ideas & Action
National Association of College Admissions Counseling
National Association of Consumer Bankruptcy Attorneys
National Consumer Law Center (on behalf of our low-income clients)
National Education Association
Project on Student Debt
U.S. Public Interest Research Group
United States Student Association
USAction

SUBMISSION FROM THE INSTITUTE FOR COLLEGE ACCESS AND SUCCESS

THE PROJECT ON STUDENT DEBT

Stories of Hardship from Private Loan Borrowers

These are the stories of real people who have agreed to speak to the media about their experiences. To get in touch with one of these borrowers or others like them, please contact Edie Irons at 510-883-7302 or eirons@ticas.org.

Stephanie from Montana was her high school's valedictorian and yearbook editor, going on to attend a prestigious private nonprofit college in the hopes of working in the nonprofit sector to give back to her community. She chose to take out private student loans to spare her single mother from taking out a Parent PLUS loan. She has over $70,000 total in student loans, with $40,000 in private loans, all from her undergraduate degree. Now a wife and a proud mother of two, she has never missed a payment on her student loans with monthly payments totaling over $700, but has taken on substantial credit card debt to pay for essentials like rent, groceries, and doctor's bills. She would consider bankruptcy if private student loans could be discharged.

Joanna from Massachusetts attended the same private nonprofit university for both her B.A. and her M.A. in Public Administration and Nonprofit Management. After graduating in 2008 she found a good job but was laid off, and since then has been unable to find a full-time job that pays enough for her to afford her student loan payments. Her federal loans are in deferment while she is unemployed, and Joanna actually turned down two job offers because they did not pay as much as she needs to afford all her student loan payments. She recently tried to put her private loans into forbearance, only to find the fee to do so was more than her current monthly payment.

Krystal from Pennsylvania attended a private nonprofit university in Chicago, taking out only federal loans, but working three part-time jobs in order to cover all her expenses. Under extreme financial and emotional stress as a result of this schedule, she took a year off to reevaluate her priorities. Enrolling at a school closer to home the following year, she decided to take out private loans so that she could work less and focus on academics. Now with $70,000 in student loans and a teaching degree, Krystal pays $200 a month for the federal loans, and $600 a month for the private loans. In two years, her private loan payments will increase $200, making her total monthly payment $1,000. She chose to teach in a low-income area so that she could get loan forgiveness for the federal loans, but because the district's status improved, she will not get the forgiveness she was counting on.

Jackie from Illinois was the first person in her family to go to college, and attended a state school in Michigan for her undergraduate degree, going on to graduate school for her professional psychology degree. Because her family was not able to help her financially, Jackie took out private loans to cover expenses after exhausting other forms of financial aid. When she went to graduate school, her private loan provider would not grant her a deferment, so she took out another private student loan to pay off the first one. As an elementary school psychologist, she now hopes to receive some loan forgiveness for her federal loans, but will not be able to get any assistance for her $35,000 in private student loans.

Mandy in Illinois graduated from a for-profit college with a degree in interior design, and $130,000 in private student loans. Though she was lucky enough to land a job shortly after graduation, she was laid off in February 2009 and is still unemployed. Mandy thought that since the starting interest rate on the private loans was essentially the same as federal loans, that they were a similar product. She has never missed a loan payment that was due, but the majority of Mandy's private loans have been in forbearance since she graduated. Her private loan balance is now $180,000 due to accrued interest. If she had to pay all of her loans every month, the monthly payment would be about $1,200. Her latest 3-month forbearance cost her a fee of $150. Eventually her opportunities for forbearances on the private loans will run out, and she will be responsible for the entire amount, with an even higher monthly payment amount. Mandy doesn't know what she'll do at that point.

Wallaine in California works both a full-time and part-time job, but her student loan payments equal the rent on her studio apartment, and she cannot afford to pay both in any one month. When she entered a master's program at a top-tier private nonprofit university, the financial aid office recommended she take out private loans but did not help her understand the costs and risks. Wallaine has inadequate employer-provided health insurance so she is also facing significant medical bills. She has delayed saving or starting a family because of her student loan debt, and struggles to afford basic necessities such as gas, groceries, and rent. She fears that she will never find relief from her "vast ocean of debt."

Roxanne in Tennessee is a single mother who went back to school to provide a better life for her child. When she inquired about financial assistance at a major for-profit school, her financial aid office gave her forms for private loans without explaining the cost or repayment burden. Roxanne tried to consolidate her private loans, and also to request a more affordable payment amount, but her lender told her that there was nothing they could do to help. Despite graduating in what she thought was a high-growth field, Roxanne still cannot find a job and believes that even if she did, her loan payments would still be unaffordable. She is worse off now than before she went to college, and regrets seeking higher education in the first place.

Alicia in Minnesota grew up in a low-income household and attended a prestigious private university and graduate program. Even after taking out all she could in federal loans and earning thousands of dollars in scholarships, Alicia couldn't afford to pay for school without borrowing private loans. Now, as a result of the private loan debt, she is delaying marriage, having kids, and buying a home. As a social worker, Alicia's salary is barely enough to make ends meet while making her loan payments, and she is unsure if she can afford to continue doing the work she loves.