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PRIVATE STUDENT LOAN BANKRUPTCY FAIRNESS ACT OF 2010

HEARING

BEFORE THE

SUBCOMMITTEE ON
COMMERCIAL AND ADMINISTRATIVE LAW

OF THE

COMMITTEE ON THE JUDICIARY
HOUSE OF REPRESENTATIVES

ONE HUNDRED ELEVENTH CONGRESS

SECOND SESSION

ON

H.R. 5043

APRIL 22, 2010

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PRIVATE STUDENT LOAN BANKRUPTCY FAIRNESS ACT OF 2010

THURSDAY, APRIL 22, 2010

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

The Subcommittee met, pursuant to notice, at 9:35 a.m., in room 2141, Rayburn House Office Building, the Honorable Steve Cohen (Chairman of the Subcommittee) presiding.

Present: Representatives Cohen, Johnson, Scott, Chu, Franks, Jordan, and Coble.

Staff present: (Majority) James Park, Counsel; Adam Russell, Professional Staff Member; and Zachary Somers, Minority Counsel.

Mr. COHEN. Thank you. This hearing of the Committee on the Judiciary, Subcommittee on Commercial and Administrative Law, will now come to order, in the presence of Mr. Apelbaum and his two beautiful young ladies.

Without objection, the Chair will be authorized to declare a recess of the hearing.

I will now recognize myself for an opening statement.

Last September, this Committee held a hearing on the dischargeability of educational debt and bankruptcy. Based on the discussion that occurred at that hearing, I have joined with Representative Danny Davis, longtime champion on this issue, to introduce H.R. 5043, the "Private Student Loan Bankruptcy Fairness Act of 2010."

Our bill is very narrowly tailored to make debt resulting from student loans issued by private, for-profit institutions dischargeable in bankruptcy. Currently, the bankruptcy code conditions the discharge of educational debt on a debtor showing that the debtor will suffer "an undue hardship" if forced to repay the debt. This standard makes educational debt effectively non-dischargeable, except in the most extreme circumstances, "undue hardship."

In 1978, Congress gave student loan creditors more favorable treatment in bankruptcy than other unsecured creditors in order to protect the viability of the Federal student loan program and, more generally, the public's money. Over the next 27 years, Congress made a series of amendments to the student loan non-dischargeability provision, making it progressively harder and harder for student borrowers to discharge their educational debt.

In 2005, Congress extended conditional dischargeability to private student loans issued by for-profit entities without any sub-

stantive discussion or empirical evidence to support such an extension. The private student loan industry contends that such an extension was needed to dissuade borrower abuse of the bankruptcy process and to minimize the risk for lenders, thereby making private loans affordable.

Now that we have had 5 years of experience with making private student loans non-dischargeable, we have found that private student loans are no cheaper than they were prior to 2005, as interest rates and fees remain high.

Moreover, private student loans continue to carry risks that are not present with Federal student loans and make bankruptcy relief more necessary for borrowers, should they run into financial trouble as private loans, lack many of the consumer protections of Federal loans.

Relative to Federal student loan borrowers, private student loan borrowers often find themselves trapped under the weight of tens of thousands of dollars of expensive, high-interest, high-fee student loan debt with no guaranteed opportunity for income-based repayment, deferment forbearance, or partial loan forgiveness, in essence, a lifetime of debt to private lenders.

H.R. 5043 addresses these concerns by amending bankruptcy code section 523(a)(8) in two ways. First, it eliminates section 523(a)(8)(B), which currently makes debt from private loans issued by for-profit lenders non-dischargeable in bankruptcy absent undue hardship on the debtor and the debtor's dependents.

Second, the bill amends section 523(a)(8)(A)(i) to clarify that only loans for which substantially all of the funds were provided by a non-profit institution remains non-dischargeable in bankruptcy. This change helps to ensure that only genuinely non-profit lenders are protected and not-for-profit lenders that issue loans guaranteed by a non-profit guarantor.

Access to education has been one of the defining issues in my legislative career, which has extended now 3 decades. As a Tennessee senator, I fought for 18 years to bring about Tennessee HOPE education lottery scholarships. I was inspired to direct the funding of the scholarship money to college loans, college tuition because of a young lady like Ms. Cooks who came to me who had been an intern in the Tennessee legislature and later came to me with pounds of debt.

And I looked at her debt, which was like 20-some-odd-thousand dollars at a time when 20-some-odd-thousand dollars was a lot of money—more like $60,000, maybe, today—and I thought, "My god, she will never be able to pay this off. The rest are for life. She will be stuck with this debt." And it just didn't seem right, and so we ended up passing our scholarship program.

But this issue is a deja vu. Students with large debts that can't get out of them and people making money, which is kind of the American way, but nevertheless, when there is a better American way, we ought to pursue it. So these scholarships gave many Tennesseans that opportunity, and they get out without as much debt or any debt because of that effort.

I view with great concern this particular issue. And seeing our young people the opportunity of America and America's future being used as fodder for people who probably are doing pretty well

already and are just doing better—and there are circumstances where we need to modify our laws to give somebody a better chance, whether it is the young student, as distinguished from the successful financial institution, I think most of us kind of go with the young student.

There may be—and I understand from the hearings—some folks that might want to be—use this as a basis to get a loan and then discharge it, and we need to find a way to ferret those out, and I think that is something we can do.

So I thank Representative Davis for his work on this issue. He has done it for a long time and has been a very, very passionate supporter. And I appreciate the opportunity to work with Senator Durbin, a great leader in the Senate. He introduced the Fairness for Struggling Students Act, Senate bill 3219, which is similar in goals and similar in approach to the bill that we have introduced here, not as artfully drafted as the one Mr. Park drew for us, but it is the Senate.

And that is where we are. So I thank our witnesses for being here today, and I look forward to their testimony.

And I now recognize my colleague, Mr. Franks, who I know has a great concern for students, as well, him having been a student at one time, the distinguished Ranking Member for his opening remarks.

[The bill, H.R. 5043, follows:]

I

111TH CONGRESS
2D SESSION

H. R. 5043

To amend title 11 of the United States Code to modify the dischargeability of debts for certain educational payments and loans.

IN THE HOUSE OF REPRESENTATIVES

APRIL 15, 2010

Mr. COHEN (for himself and Mr. DAVIS of Illinois) introduced the following bill; which was referred to the Committee on the Judiciary

---

A BILL

To amend title 11 of the United States Code to modify the dischargeability of debts for certain educational payments and loans.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

This Act may be cited as the "Private Student Loan Bankruptcy Fairness Act of 2010".

SEC. 2. EXCEPTIONS TO DISCHARGE.

Section 523(a)(8) of title 11, United States Code, is amended—

(1) by striking subparagraph (B), and

(2) in subparagraph (A)—

(A) in clause (i)—

(i) by striking "(i)", and

(ii) by inserting "any program for which substantially all of the funds are provided by a" after "unit or", and

(B) in clause (ii)—

(i) by striking "(ii)" and inserting "(B)", and

(ii) by striking "or" at the end.

SEC. 3. EFFECTIVE DATE; APPLICATION OF AMENDMENTS.

(a) EFFECTIVE DATE.—Except as provided in subsection (b), this Act and the amendments made by this Act shall take effect on the date of the enactment of this Act.

(b) APPLICATION OF AMENDMENTS.—The amendments made by this Act shall apply only with respect to cases commenced under title 11 of the United States Code on or after the date of the enactment of this Act.

○

Mr. FRANKS. Thank you, Mr. Chairman. I think I am still a student.

Yes, Mr. Chairman, I have to say at the outset, so that my perspective is taken in context and from the point of view and the spirit that it is given, that some of us in this Congress believe that government should not be measured by how many people it helps, but by how many people no longer need government's help.

So I want to make that clear. It is never a—I think sometimes that those of us that are against bills like this are seen as not caring about the people, but we are concerned that this will even cause them greater harm in the long run than it would have had it been left as it was.

So let me just start out and say that H.R. 5043 makes private student loans fully dischargeable in bankruptcy. Currently these loans are dischargeable only if repaying the loans would constitute an "undue hardship."

This bill singles out private student loans for less favorable treatment in bankruptcy than loans funded by the government and nonprofit organizations. Now, why should we single out private student loans for less favorable treatment? Private student loans are an important means for financing higher education. They are used to help fill the gap between the actual cost of attendance and the limits on Federal loans and school-provided financial aid.

And because this gap is increasingly growing wider, private loans are becoming a more and more important tool to finance education. In fact, the student from the Institute for Higher Education policy found that "private loans help students attend schools that they want to attend, rather than the schools that they might have to attend because of inadequate financial resources."

The exception from bankruptcy discharge that private student loans currently receive is vital. First, the exception ensures that private capital continues to flow into the student lending market. This is kind of an important point, Mr. Chairman, which has tightened considerably over the last 2 years due to economic conditions.

Student lenders are finding it more difficult to raise capital because investors are not buying securities backed by student loans. Why would they?

Legislation like H.R. 5043 that makes student loans less attractive to investors will inevitably have the effect of shrinking an already depressed private student loan market. If lenders are forced to scale back student lending because private student loans are subject to bankruptcy discharge, many students will be denied access to higher education.

Second, the bankruptcy exception for student loan wards off abuse by student borrowers. Unlike other debt, student loans are secured only by the anticipated future success of the individual student borrower. Upon graduation, student borrowers typically have few assets to discharge from just—from filing bankruptcy.

However, student borrowers have substantial future earnings potential. The bankruptcy exception for student loans is designed to remove the potential for recent graduates to use the bankruptcy system to unencumber those future earnings.

In short, 5043 will discourage private lending and encourage abuse of the bankruptcy system. Moreover, this legislation is a blunt force rather than a nuanced approach.

If the current law is too harsh, then, Mr. Chairman, let's clarify what constitutes an undue hardship. There is a great deal of work that we could do there, latitude that we could do there, because we all understand undue hardship.

Or if certain private loans are abusive, then let's create a "safe harbor" for future—for the features a private loan must have to get the protection. Let's not target all private loans based on a subset of arguably abusive loans or lenders.

Mr. Chairman, H.R. 5043 is not the answer to the growing debt burden that our Nation's graduates face. The real culprit is the rising cost of higher education. Nothing in this legislation will even remotely address that problem. In fact, as lenders are forced to increase the pricing of student loans to account for the new risk this bill creates, borrowers will end up paying even more for higher education.

And, Mr. Chairman, I guess the thing that is the greatest concern to me is that I believe that this legislation is well intended, but it will inevitably have the effect of hurting the very ones that it ostensibly intends to try to help. So with that, I yield back.

Mr. COHEN. Thank you, Mr. Franks.

Do Mr. Johnson or Mr. Scott seek recognition? Mr. Johnson is recognized for an opening statement, distinguished Chairman of the Subcommittee on Antitrust.

Mr. JOHNSON. Thank you, Mr. Chairman, for holding this very important hearing on the Private Student Loan Bankruptcy Fairness Act. Fairness is so important, and I know you have had a long history of working in this area to ensure fairness.

And it is imperative that we examine the issues of dischargeability of 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. It is also the same economy that allows corporations to wipe out their pension obligations to retired workers under the bankruptcy code.

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, as naive and financially unsophisticated young people, agree to be confusing terms of a private loan agreement in order to get an education to become productive citizens and contribute to our society.

And unlike Federal loans, private student loan borrowers are often unable to work out terms that ensure a reasonable and fair repayment schedule. Federal loans contain mechanisms to ensure

repayment without excessive financial distress on the part of the borrower. Private loan students—private student loans lack access to the most important deferment income-based—income-based repayment or loan forgiveness options that come with Federal student loans.

This leaves most private student lender—excuse me. This leaves most private student loan borrowers at the mercy of the lender if they face financial distress due to unemployment, disability or illness.

In short, private student loans must be addressed as we have a responsibility to ensure that our youth can obtain a quality education without going broke.

Thank you, Mr. Chairman, for scheduling this hearing. I look forward to the hearing and from our witnesses today. Thank you.

Mr. COHEN. Thank you, Mr. Johnson.

We now will start the panel. And, Mr. Scott, did you desire to make an—you just desire to lobby Mr. Johnson? Okay, good luck.

I am now pleased to introduce the witnesses and hear their testimony for today's hearing. First, thank you all for participating. Our program, like all others, is that your written statements, without objection, will be placed in the record.

I ask you limit your remarks to 5 minutes. You have got a lighting system kind of in front of you there, and when it is green, it means you are starting, and you have got—you are within the 4 minutes of your opening. When it gets to yellow, you have got a minute to wind down. And when it gets to red, Beulah blows the buzzer and you are finished, so you need to be completed.

We have an opportunity for each witness after their testimony for Subcommittee Members to ask you questions. We are also under the same 5-minute red, yellow, green program, and—but we can submit questions to you later, so it doesn't mean you are home-free.

Our first witness is Ms. Deanne Loonin. Ms. Loonin is the staff attorney with the National Consumer Law Center and the director of the National Consumer Law Center's student loan borrower assistance project, a resource for borrowers, their families, and advocates representing student loan borrowers.

She assists attorneys representing low-income consumers and teaches consumer law to legal services, private consumer attorneys, and other advocates. She also provides direct representation of low-income student loan borrowers and maintain student loan borrower assistance Web sites. She has served as legal aid representative at the recent Department of Education negotiated rule-making sessions.

Prior to joining the NCLC, she worked at legal services in Los Angeles known as DEC—DEC? Whatever. You got it.

Thank you for being here. We appreciate Ms. Loonin and appreciate her for announcing the name of her 1997 employer. And now you can begin your testimony.

TESTIMONY OF DEANNE LOONIN,
NATIONAL CONSUMER LAW CENTER, BOSTON, MA

Ms. LOONIN. Thank you very much, Mr. Chairman, and the other Members of the Committee. Thank you for inviting me here to testify today.

I am here today on behalf of NCLC's low-income clients. Through my work at NCLC, I hear not only from these clients who I work with directly, but also from thousands of student loan borrowers through my Web site and also through the attorneys and advocates I work with across the country who also represent student loan borrowers.

It is a diverse group of students who I hear from, all ages, all class levels, all different parts of the country, but they all have one thing in common, at least one thing in common. They all tried to better themselves through education.

It is one of the strongest messages out there as we grow up. If you go to college, you are much more likely to succeed, and they listen to that message. Some graduated who I hear from; some didn't. It is a diverse group, as I said. But one other thing they all have in common, more unfortunately, is that they are all struggling with the debt burden of student loans.

When they come into my office, it is sort of a frustrating scenario, but what usually happens is we first try to figure out, what kind of student loan does the person have? And most borrowers have no idea, very confusing. It is a complex process, understanding the difference between a private loan and a Federal student loan.

The way I know it is a private student loan is I look at the interest rate. And I see, unfortunately, APRs 11 percent, 12 percent, 13 percent, higher, up to sometimes over 20 percent. And that is when we know for sure there are other ways to tell, too, that this is a private loan we are dealing with.

If it is a Federal student loan, they could still be very deep in debt. It is still a problem. But there are some imperfect, but some of them actually better than imperfect solutions out there for those borrowers.

When I talk to the private loan borrowers, it is a completely different story. Basically, we have to try to negotiate with the lenders—and I do this all the time, and they offer virtually nothing for my clients.

The consequences to these—to these borrowers are severe in terms of their credit report, in terms of their psychology, in terms of thinking about whether they ever want to go back to school again. It is a huge burden for them, and bankruptcy is not a realistic option.

That is why we are here today in support of this legislation, not because bankruptcy is the best option—I want to be clear about that. When I speak to my clients, they always tell me, "We really don't want to file for bankruptcy." It is considered a failure in their eyes in a lot of ways or humiliating. But in some cases, it is the only choice they have to move on with their lives.

So we support the legislation for them, but also because there is no rationale for this heightened standard for students—for the private student loans. And I want to just go through a couple of rea-

sons in the few minutes I have left that we often hear. Some of them—some of these reasons have already been mentioned.

The first one is that we need this restriction to stop the supposed excess filing by student borrowers. There is no evidence that there was ever such excess filings. And in fact, there are safeguards in the bankruptcy system—many of them passed in 2005, when the—with bankruptcy reform—that can weed out such borrowers.

The other reason we hear a lot is, well, we need this restriction to make private loans more available, sort of an incentive system though the bankruptcy system.

Well, the first question I would ask is whether that is a legitimate goal for bankruptcy policy, because private loans are not financial aid. They are private credit products. But even if you consider this a goal, it hasn't worked. Lenders have responded to the market, not to bankruptcy policy.

The industry grew, frankly, very, very astronomically and exploded quite a bit prior to the 2005 change, and as was mentioned, the industry has contracted more recently, and yet there is still the restriction in the bankruptcy policy. So, again, the lenders are responding to the market incentives, not to the bankruptcy policy.

Another rationale is that this will supposedly make the private loans less expensive. Well, this, too, has not happened. We have seen the most high-rate, other kinds of subprime private loans during the time that the bankruptcy restriction has been in place.

The policy has also not improved college access. In fact, college enrollment is now growing even though private loans are less available. And the last thing I would say is, we certainly know that the policy has not made college more affordable. Tuitions have continued to grow.

So we urge passage of this bill to help the struggling borrowers who I work for who, unfortunately—I wish they could all be here today with me, but I am here on their behalf. And what they did was they chose education; they deserve an opportunity for a fresh start.

And I am happy to answer any questions later. Thank you very much.

[The prepared statement of Ms. Loonin follows:]

PREPARED STATEMENT OF DEANNE LOONIN

Testimony before the

U.S. HOUSE OF REPRESENTATIVES COMMITTEE ON THE JUDICIARY

SUBCOMMITTEE ON COMMERCIAL AND ADMINISTRATIVE LAW

regarding

"The Private Student Loan Bankruptcy Fairness Act of 2010"

April 22, 2010

Testimony submitted by:

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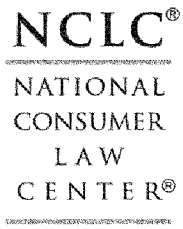
Attorney

National Consumer Law Center (NCLC) and

Director of NCLC's Student Loan Borrower Assistance Project



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Testimony of Deanne Loonin for the

U.S. House of Representatives Committee on the Judiciary

Subcommittee on Commercial and Administrative Law

regarding

"The Private Student Loan Bankruptcy Fairness Act of 2010"

April 22, 2010

Mr. Chairman and Members of the Committee, the National Consumer Law Center (NCLC) thanks you for holding this hearing today. 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 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]

In my work as the Director of NCLC's Student Loan Borrower Assistance Project, I provide training and technical assistance to attorneys and advocates across the country representing low-income student loan borrowers. I have written numerous reports on student loan issues as well as NCLC's *Student Loan Law* publication. I also provide direct representation to low-income borrowers through Massachusetts-based legal services and work force development organizations. Many of these borrowers seek assistance because they are trying to rebuild their lives after escaping domestic violence or homelessness. The non-profit work force development organizations help them get G.E.Ds if necessary and hopefully move on to higher education. However, many cannot take this next step because of prior student loan debt. I also have daily contact with a wide range of borrowers through our student loan web site. Because of my extensive experience representing student loan borrowers and working on student loan matters, I have served as the legal aid representative at a number of Department of Education negotiated rulemaking meetings, including the most recent session on program integrity. My testimony is based on this work and previous work representing low-income consumers at Bet Tzedek Legal Services in Los Angeles.

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[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.

Introduction

Even during these difficult economic times, there is one consistent message that Americans hear as they grow up—You are more likely to succeed if you go to college. President Obama affirmed this message when he announced goals to have the highest proportion of students graduating from college in the world by 2020.

Students go to college to improve their lives. Unfortunately, not everyone succeeds, especially not financially. Far too many never graduate. College completion rates in the U.S. have been flat since the 1970's among all sectors of higher education. Some students graduate, but are unable to find work to repay burdensome debt loads.

It is increasingly difficult for students to figure out how to pay for college. Tuition keeps growing while scholarship and grant aid shrinks. A growing number of students must rely on loans to finance their educations. The increased borrowing is not only from federal loans. The borrowing limits in the federal loan programs, the skyrocketing cost of higher education and aggressive lender marketing have fueled the growth of private student loans, which are almost always more expensive than federal loans.

Despite the growing perils of trying to pay for college, Congress has consistently weakened the safety net, including bankruptcy, for those who try, but end up unable to repay their education debts. Our experience working with low-income borrowers is that bankruptcy is almost never their first choice. Most express a desire to avoid bankruptcy because it feels like a failure. They also fear the stigma and the resulting difficulties of finding employment, housing, and utilities. However, for many, bankruptcy is the only way to get a fresh start in life.

Bankruptcy is not and should not be the entire safety net, but it is the most organized and effective system we have to offer relief to those who most need it. It is never an easy decision for a consumer to choose bankruptcy. This choice comes with many costs and consequences, including damaged credit that lasts for years. However, it was a choice that was available to private student loan borrowers before 2005 and is still fully available to nearly all other unsecured debtors. For student loan debtors, however, bankruptcy relief is now available only through the random, unfair, and costly "undue hardship" system. Effectively, it has become no choice at all for those who most need it.

We see and hear the human toll of the eviscerated student loan safety net every day from the low-income borrowers we represent. Some are so traumatized by collection calls and skyrocketing debt loads that they vow never to try education again. These choices not only impact these individuals and their families, but society as well. As evidenced by the Obama Administration's higher education goals, 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.[3] 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.

Trouble in the Private Loan Industry

The private student loan industry generated huge profits for lenders and investors for many years. The private loan market was profitable largely because originators sold the loans with the intention of packaging them for investors. Lenders aggressively marketed these products to keep fueling the securitization pools, developing products for the repackaging rather than to provide the most affordable and sustainable products for borrowers.[4]

Over time, however, just as in the subprime mortgage industry, the defects in these expensive, unsustainable products became clear and the loans began to fail. The industry hit a wall, exposing the risks of making unsecured, expensive loans to borrowers with little or no ability to repay.

All of the major private student lenders have written off huge volumes of loans. The worst performing portfolios have been "non-traditional" loans. Lenders describe these as loans to borrowers that are expected to have a high default rate due to numerous factors including having a lower tier credit rating or low program completion and graduation rates usually at "non-traditional schools." Even where the borrower is expected to graduate, non-traditional loans tend to go to borrowers with low expected incomes relative to the cost of attendance.[5]

Sallie Mae and others have attributed much of the poor performance of private student loans to their "non-traditional" loan portfolio.[6] Non-traditional loans at both for-profit and non-profit schools represented about 14% of Sallie Mae's private education loan portfolio, but accounted for 54% of charge-offs in the company's portfolio in 2008.[7] Even Sallie Mae's then-CFO Jack Remondi admitted that this is "… [o]bviously, a business model that does not make sense."[8] More recently, Sallie Mae's CEO referred to the "bad lending bubble" of non-traditional lending from 2004-2007 and noted that this type of lending has been "totally discontinued."[9]

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[3] Megan McArdle, "Sink and Swim" The Atlantic (June 2009).
[4] See generally National Consumer Law Center, "Paying the Price: The High Cost of Private Student Loans and the Dangers for Student Borrowers" (March 2008), available at: http://www.studentloanborrowerassistance.org/uploads/File/Report_PrivateLoans.pdf.

[5] Fitch Ratings, "Private Education Loans: Time for a Re-Education" at 7 (Jan. 28, 2009).
[6] Id.
[7] Alejandro Lazo, "Sallie Mae Forecasts Surge in Defaults", *Washington Post* (Jan. 23, 2009).
[8] SLM Corporation Q4 2007 earnings Call Transcript (Jan. 23, 2008).
[9] Based on October 21, 2009 Sallie Mae earnings call transcript.

These belated admissions can be useful in policy debates because they expose the inexcusable wishful thinking that was masked as business planning over the years. However, these *mea culpas* do not do much for troubled borrowers.

The reality is that many loans were so expensive that they were destined to fail. In a March 2008 report, NCLC reviewed twenty-eight private loans issued between 2001 and 2006, looking for warning signs and potential problems.[10] All of the loans in our survey had variable rates. The lowest initial rate in our sample was around 5% and the highest close to 19%. The average initial disclosed annual percentage rate (APR) for the loans in our survey was 11.5%.

The high fees made these loans even more expensive. There are no limits on origination and other fees for private student loans. According to the loan disclosure statements we reviewed, the lenders charged origination charges in all but about 15% of the loans. For those with origination fees, the range was from a low of 2.8% up to a high of 9.9% of the loan amount. The average in our survey was 4.5%.

As the market has declined, lenders have adapted or left the market. It is the students who are stuck with nowhere to turn.

Holes in the Safety Net

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. The current undue hardship system is arbitrary, unfair and denies relief to the most vulnerable student loan borrowers.

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

[10] National Consumer Law Center, "Paying the Price: The High Cost of Private Student Loans and the Dangers for Student Borrowers" (March 2008), available at: http://www.studentloanborrowerassistance.org/uploads/File/Report_PrivateLoans.pdf.

bankruptcy. This compares favorably with the consumer finance industry. [11]

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.[12]

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. Congress made this change even though private student loans are not part of the federal financial aid system, which was created to promote equal access to higher education. Nearly all government loans are made to eligible borrowers regardless of their credit histories. Federal student loan terms and fees are strictly regulated. Private loans, in contrast, are almost always more expensive than federal loans. This is especially true for borrowers with lower credit scores or limited credit histories. Private loans also do not have the same range of protections for borrowers that government loans have. Further, borrowers are more likely to borrow unaffordable amounts since, unlike most federal loans, there are no loan limits for private loans.

Even those who insist without evidence that students are more likely to file bankruptcy should be able to agree that the changes made to the bankruptcy laws in 2005 address this issue. Congress added a number of new elements to the personal bankruptcy system in 2005, 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.

"Undue Hardship" and Lack of Relief

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

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

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.[13] 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.[14]

Many courts use the so-called *Brunner* test to evaluate hardship.[15] 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 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."[16] 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.[17] In criticizing the test, another judge noted that *Brunner* was "...made up out of whole cloth anyway."[18] 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*.[19]

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

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[13] 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).
[14] Id.
[15] *Brunner v. New York State Higher Educ. Servs. Corp.*, 831 F. 2d 395 (2d Cir. 1987).
[16] *ECMC v. Polleys*, 356 F. 3d 1302 (10th Cir. 2004).
[17] Id.
[18] *In Re Cummings*, 2007 WL 3445912 (Bankr. N.D. Cal. Nov, 13, 2007).

[19] *In re King*, 368 B.R. 358 (Bankr. D. Vt. 2007)

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.[20]

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.[21]

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 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 were offering some very limited, flexible repayment options for financially distressed borrowers.[22] These lenders rarely cancel loans or offer reasonable settlements. Fundamentally, lenders who make private student loans are not obligated to offer repayment modification or relief under any circumstances, leaving borrowers truly at the mercy of their lenders.

More recently, some lenders have begun reviewing their policies and have suggested that they will be more flexible with some borrowers. Our experience, however, is that this increased flexibility is rarely extended to the lowest-income borrowers who can afford to pay very little, yet generally have the highest rate loans. We have found that even when lenders do offer some flexibility, these are usually short-term interest-only payments plans that do not extend loan terms.

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

[20] *In re Stebbins-Hopf*, 176 B.R. 784 (Bankr. W.D. Tex. 1994),
[21] Rafael I. Pardo, Michelle R. Lacey, "The Real Student-Loan Scandal: Undue Hardship Discharge Litigation", 83 Am. Bankr. L.J. 179 (Winter 2009).
[22] The report is available on-line at:
http://www.studentloanborrowerassistance.org/uploads/File/TooSmalltoHelp.pdf.

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.

The options are particularly limited for borrowers in default. We hear again and again that once a loan has been written off, there is nothing the lenders can do. 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.

Too often, even students who graduate are left with no relief. One of our clients, Brittany, is a young woman in her early 20's who graduated with a hospitality management undergraduate degree from a reputable Boston-based private college. While the degree seemed likely to lead to work five years ago, she has found since graduation that it is nearly impossible to find employment in the field. Instead, she is working for now as a waitress making close to minimum wage.

Brittany received just over $20,000 in federal government loans plus Pell grants. She is looking into income-based repayment to keep those loans out of default. Unfortunately, she also has about $65,000 in private loans. Like many borrowers, she was confused about the difference between federal and private loans. As a result, she did not exhaust all of her federal loan eligibility. Unfortunately, this is very typical. The Project on Student Debt has found that almost two-thirds of private loan borrowers in 2007-08 borrowed less than they could have in federal Stafford loans, compared to less than half of private loan borrowers in 2003-04.[23]

Brittany cannot afford to pay her private loans with her current limited salary. The minimum payment is over $600/month. Her mother co-signed one of the loans, but also cannot help because she recently lost her job and is facing potential foreclosure.

The Problem of Fraudulent Schools

Many of the most vulnerable borrowers are proprietary school students who attended schools that left them with huge debts, but little or nothing in the way of education. These students have been hit particularly hard. They are stuck with debts they cannot repay from worthless schools.

For years, lenders fought to get into the largely unregulated world of high-growth proprietary higher education. During this time, a particularly unholy alliance developed between

[23] The Project on Student Debt, "Private Loans: Facts and Trends" (August 2009), available at: http://projectonstudentdebt.org/files/pub/private_loan_facts_trends_09.pdf.

unlicensed and unaccredited schools and mainstream banks and lenders.[24] The creditors did not just provide high-interest private loans to students to attend unscrupulous schools; they actually sought out the schools and partnered with them, helping to lure students into scam operations. They then turned around and, like subprime mortgage providers, made big profits on these loans by securitizing them and shifting the risky debt onto unsuspecting investors.

Our client Joe is one example of many clients we have seen facing these burdens. Joe is a 25 year old student at Salem State College in Massachusetts. Without a glaring problem from his past, he would be much like many other students at the state college. He works part-time to help meet expenses, is articulate, ambitious and personable. He took out federal loans to help defray expenses at the public college. Unfortunately, about five years ago, he saw an advertisement for a for-profit culinary school. He visited the school and was told about the amazing curriculum and strong job placement program. The price tag of about $35,000, they said, would be easily repaid through lucrative earnings after graduation. Joe was young and impressionable and eager to work in the culinary field, so he signed up. He found out almost immediately that the school's statements were empty promises. The teachers were inexperienced and the materials and equipment inferior. He asked about leaving and was told that he could not get a refund. He stayed and finished and was never given job placement assistance, despite his requests. He has since moved on and tried to put the experience behind him, but the loans will not go away. He thinks he will be able to manage the federal loans, but his two private loans with current interest rates of about 15% are unaffordable. He says he wants to pay something and has asked for a break, but the creditor offers only forbearances and in-school deferments. Joe is angry and frustrated and has nowhere to turn.

You will likely hear similar sentiments from the approximately 2,500 former students of Silver State Helicopters, a Nevada-based for-profit flight school that went into bankruptcy. Most of these students received private loans to cover costs and are stuck with incomplete educations from a school that abruptly closed, while also facing demands from lenders insisting on repayment.

Most bankruptcy courts are unmoved by borrowers who went to fraudulent schools. Judges 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.[25] Many courts assume that these borrowers can get relief instead through the

[24] An example is ongoing litigation against Silver State Helicopters. See "Pinnacle Law Group Files Class Action on Behalf of Students Against Keybank for Predatory Lending Practices in Connection with Failed Vocational School, Silver State Helicopters" (May 12, 2008), available at: http://www.pinnaclelawgroup.com/pdf/SSH-KeyBank_PressRelease.PDF.

[25] *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).

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.

Bankruptcy Policy and the 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. For example, industry-wide, 80-90% of private student loans originated in 2009 required a cosigner, up from 50-60% in 2007.[26]

The fact is that the private student loan industry grew rapidly during the pre-2005 period when these loans were fully dischargeable in bankruptcy. This should not be so surprising. During the past decades of irresponsible lending, creditors threw credit around like candy in markets where the credit was dischargeable in bankruptcy (such as credit cards) and those where it was harder to write off debts in bankruptcy.

The industry has contracted in recent years even with a restrictive bankruptcy policy. For example, Sallie Mae's private loan originations were down 55% in the fourth quarter of 2009 compared to the same period the previous year.[27] The company cited tightening of underwriting criteria as a major reason for the decrease in loan volume. The more restrictive credit market has helped eliminate loans that never should have been made. This has forced schools and lenders to think twice before pushing these high priced products, a welcome market correction.

There is simply no good evidence that bankruptcy policy has much impact on creditor behavior. Interest rates, for example, were largely the same before and after the 2005 bankruptcy law which made private student loans more difficult to discharge in bankruptcy.

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[26] Based on 2009 estimates by Student Lending Analytics, a research and advisory firm based in Palo Alto, California.

[27] Student Lending Analytics Blog, "In Search of Answers in Sallie Mae's 4Q Supplement: Private Loan Originations Down 55%, Delinquencies Remain High" (January 20, 2010).

The business of private lending has expanded and contracted based on market opportunities, not based on bankruptcy policy. Some lenders continue to make high rate, risky loans even during the current economic climate. While some of the larger lenders have at least temporarily tightened criteria, other, less selective lenders have stepped into the market. In some cases, for-profit schools are making private loans knowing that the majority of their students will not be able to repay. Corinthian Colleges, for example, has told investors that it expects its students will not be able to repay 56-58% of its institutional private loans. Yet they keep making these loans, even with a restrictive bankruptcy policy, presumably because it lures students to their schools and gives them access to federal student aid dollars.

The road to higher access to education will never be paved with high rate private loans. Our nation's record in helping low-income and other less advantaged students enter and complete college has been woefully inadequate when the private loan industry was booming and now that it is, at least temporarily, in decline. Yet students continue to try to improve their lives through education. Despite the decreased availability of private student loans, college enrollment has continued to grow. In fall 2008, total college enrollment, including all undergraduate and graduate students, surged by 3.7%, the largest percentage increase since 2002, even though private student loan volume dropped by an estimated 30% or more for the 2007-08 school year.[28]

Conclusion

Restricting the bankruptcy safety net helps give private lenders some additional peace of mind and potentially more profits. These goals reflect industry interests, not the key policy goals of improving access to education and making college more affordable.

Bankruptcy policy should be about the pragmatic need to offer fresh starts to many debtors. Bankruptcy is the legal recognition that someone lacks the resources to meet financial obligations. There are many rules in place to ensure that only borrowers who are financially distressed get relief. It is way past time to give financially distressed student borrowers equal access to relief.

[28] Enrollment figures based on data available through the U.S. Department of Education's Integrated Postsecondary Education Data System (IPEDS) and private loan volume estimates based on data available through the College Board and by Student Lending Analytics, compiled by the Project on Student Debt.

Mr. COHEN. Thank you, Ms. Loonin. I appreciate your statement and your timing your statement perfectly.

The next witness will be Mr.—is it "Hupalo"? Mr. Hupalo is managing director at Ramirez Capital Advisers—or Edvisers. Nice play on words, I guess.

Previously, he served as the CFO and senior executive vice president of the First Marblehead Corporation, one of the largest publicly traded student lenders. Prior to that, he was managing director in the education loan group at UBS, Salomon Smith Barney, and Manufacturers Hanover security corporation.

Thank you, sir, and we welcome your testimony.

TESTIMONY OF JOHN A. HUPALO,
RAMIREZ CAPITAL ADVISORS, WESTON, MA

Mr. HUPALO. Thank you, Mr. Chairman, Ranking Member Franks, the other Members of the Committee for the invitation to be here this morning.

My experience with student loans began in 1978 as a borrower. And I am deeply indebted to the Congress for passing that legislation and giving first-time college aspirants like myself this opportunity.

Although I did not initially plan for my professional career to be focused on helping others pay for college, it has.

As you noted, my work in investment banking and at First Marblehead Corporation, I focused on helping both state agencies and not-for-profit companies around the Nation, as well as for-profit companies, structure a responsible private student loan program.

The narrow, but important question you asked today—whether to permit the discharge of private student loans to bankruptcy—is another in a long line of policy issues which in isolation appear fairly simple, but are actually quite complex when considered along the broader spectrum of education lending policy.

I understand the intended benefit of repealing non-dischargeability of private student loans, but I am very concerned that it will be counterproductive to the country's shared goal of making college education more accessible to the greatest number of students possible.

Although I am not an expert in Federal bankruptcy law, I do understand why non-dischargeability is a cornerstone of keeping private student loan interest rates affordable. Unlike most other loans, student loans are generally made to very young borrowers. At a time of borrowing, they have no job, no immediate prospect for a job, no credit history, and often no other assets.

Furthermore, the loan products themselves are the most friendly consumer products in the marketplace. The loan may be paid over a relatively long period of 10 to 30 years, most not requiring any payment until a student separates from school, often many years after the first loan was made. There are no prepayment penalties for borrowers who wish to pay ahead of schedule, and there are opportunities for borrowers to stop making payments for a period of time even after the repayment period commences.

This combination of borrower profile and product is very difficult for lenders to serve absent some other incentive to make the socially necessary loans. Non-dischargeability is one such feature.

When lenders—be they not-for-profit state agencies, for-profit financial institutions, schools, or finance companies, or the Federal Government, for that matter—enter into the competitive marketplace, they share a few commonalities, including the requirement

that the loans make some amount of money, a risk-adjusted return for the lender.

Admittedly, the nomenclature can be confusing. Even lenders with nonprofit charters and public purpose missions need to offer economically responsible, profitable products to be viable. This is true for the Federal Government loan programs, as well.

In order to design such a product, the lender must assess the risk that a borrower will be unable to repay the loan in full. Private student lenders faced with borrower profiles and required product sets previously discussed create lower-cost loans as a result of the value of the non-dischargeability.

There is no question that interest rates for all borrowers would have to increase in order to compensate for the increased risk if borrowers had the option to routinely discharge private student loans.

Students are smart, but relatively immature consumers of very expensive goods and services, like a college education. Some would undoubtedly seek to exploit the narrow question of today's discussion. With no assets to lose, an education in hand, why not discharge the loan without ever making a payment?

I fear that borrowers just out of school would discount other risks and be saddled with unintended consequences for many years to come with a bankruptcy noted on their credit profile for 7 or more years that will hamper their ability to buy furniture or a car or other necessary consumer goods or even their first home on credit. In the long run, discharging this debt will not benefit these borrowers.

The plight of these borrowers, however, should be properly addressed with existing law using the undue hardship exemption. Judges may benefit from a clearer explanation of congressional intent in this area and more specific criteria.

I hope that this perspective is useful to you. I will make two other brief comments.

First, the bill removes non-dischargeability retroactively. A retroactive re-writing of a contract strikes me as simply wrong. How could any transaction in our consumer society be taken seriously if the material terms could be retroactively changed by one party—or one party or another or the U.S. Congress?

As I noted earlier, lenders initially priced loans based on the perceived risk and mitigants including the contract's non-dischargeability. Furthermore, investors around the world who previously purchased these loans in the secondary market would no doubt be injured by retroactively negating the non-discharge provisions. Preserving the sanctity of this contract law should be paramount.

Second, the legislation calls for separate treatment of dischargeability for for-profit and not-for-profit entities. Maintaining the 2005 legislation's goal of identical treatment of dischargeability for private student loans, regardless of the corporate structure, continues to make sense.

Creating classes of lenders is inequitable and will lead to marketplace confusion. Students already face a dizzying array of choices when selecting a loan product. Adding the consideration of different bankruptcy options will only further confuse them. All private loans should be non-dischargeable.

In conclusion, I again commend the Subcommittee for taking on this hearing. Although the proposed legislation is no doubt well intended, I am concerned that it could increase the cost of all private student loans, reduce access for some borrowers, and increase the risk of unintended consequences for those who successfully discharge their loans.

If the Subcommittee's goal is to protect the most distressed borrowers, then I believe that clarifying the undue hardship standard—a current consumer protection lynchpin for student loan borrowers—is far preferable to undoing the 2005 legislation.

Thank you.

[The prepared statement of Mr. Hupalo follows:]

PREPARED STATEMENT OF JOHN A. HUPALO

Testimony of

John A. Hupalo
Managing Director
Samuel A. Ramirez & Co., Inc.

U.S. House of Representatives Committee on the Judiciary
Subcommittee on Commercial and Administrative Law

Hearing on the "Private Student Loan Bankruptcy Fairness Act of 2010"

April 22, 2010

Thank you Chairman Cohen, Ranking Member Franks and the other distinguished members of the Subcommittee for the invitation to testify this morning. I commend the Chairman and members of the Subcommittee for continuing the work begun last September to better understand how making a seemingly simple change to the bankruptcy code might affect students as they seek the most affordable alternatives to financing their educations – a goal shared by all.

My name is John Hupalo. I am a Managing Director at Ramirez Capital Advisors, a group specializing in student loan finance at Samuel A. Ramirez and Co. I need to begin with the disclaimer that the views I express here today are my own personal opinions and do not represent the views of my employer or any other organization.

My experience with student loan programs began as a borrower in 1978. I am deeply indebted to the United States Congress for creating a student loan program that afforded first generation college aspirants like me an opportunity for educational advancement we may otherwise not have had. The programs were then, and remain today, essential to providing access to education for many Americans.

Although I did not initially plan for my professional career to be focused on helping others pay for college, it has. In 1987, after a stint here on the Hill and then obtaining my MBA, I began working with state agencies and other not-for-profit entities on ways to cost-effectively finance student loans made under the auspicies of both the federally guaranteed student loan program as well as loan programs that did not benefit from a federal guaranty or subsidy. These necessary programs are now known as private student loans because they were and are created with credit underwriting criteria akin to other consumer loans such as mortgages or credit cards or auto loans. I also helped for-profit student loan entities -- including The First Marblehead Corporation where I served as the Chief Financial Officer – to structure responsible private student loan programs.

The issues today, unlike 1978, are significantly more complicated as college costs have significantly outpaced inflation during that time, the amount of debt borrowers have procured is at record levels, the Congress has been engaged in a decades long debate over the most advantageous student loan delivery system and most recently the melt down of the global credit markets has wreaked havoc on traditional sources of education funding. We are all concerned that student access to education may be compromised as a result.

The fairly narrow, but important, question you consider today – whether to permit the discharge of private student loan debt in bankruptcy – is another in a long line of policy issues which in isolation appear fairly simple but are quite complex when considered along the broader spectrum of education lending policy. I understand the intended benefit of repealing non-dischargeability of private student loans, but I am concerned that it will be counter-productive to the country's shared goal of making a college education more accessible to the greatest number of students possible.

Although I am not expert in the federal bankruptcy code, I do understand why non-dischargeability is a cornerstone to keeping private student loan interest rates as affordable as possible. Unlike other loans, student loans are generally made to very young borrowers who at the time of the borrowing have no job, no prospect of a job, no credit history and often no other assets. Furthermore, the loan products themselves are the most consumer friendly loans in the market place: the loan may be paid over a period of 10 – 30 years, most do not require any payments until a student separates from school – often many years after the loan was first made, there are no prepayment penalties for borrowers who wish to pay ahead of schedule, and there are opportunities for borrowers to stop making payments for a period of time even after the repayment period commences. The combination of this profile of borrower and product is very difficult for lenders to serve absent some other incentive to make these socially necessary loans: non-dischargeability is one such feature. This provision is also important to investors who purchase loans in the secondary market.

When lenders – be they (a) not-for-profit or state agency lenders, (b) for-profit financial institutions, schools or finance companies, or (c) the federal government – enter the competitive student loan market place, they share a few commonalities including the requirement that the loans make some amount of money for the lender. Admitedly, the nomenclature can be confusing. Even lenders with non-profit charters and public purpose missions need to offer economically responsible, profitable products to be viable. This is true for the federal government loan programs as well. In order to design such a product, the lender must assess the risk that a borrower will be unable to repay the loan in full – a common question for lenders across all asset classes: mortgages, home equity loans, credit cards, automobiles, boats and every other type of loan you can name. Private student lenders faced with the borrower profiles and required product set previously discussed create lower cost loans as a result of the value of non-dischargeability. There is no question that interest rates for all borrowers would have to increase in order to compensate for the increased risk of loss if borrowers had the option to routinely discharge private student loan debt.

Students are smart but relatively immature consumers of very expensive goods and services, like a college education. Some would undoubtedly seek to exploit the narrow question of today's discussion. With no assets to lose, an education in hand, why not discharge the loan without ever making a payment to the lender? I fear that borrowers just out of school would discount other risks and be saddled with unintended consequences potentially hampering their ability to buy furniture or a car or their first home on credit a few short years after the discharge. In the long run, discharging this debt would not be a net benefit to these borrowers.

Having said this, few would disagree that college costs have risen too quickly, and too many students have taken too much credit over too long a period of time. These issues are being addressed separately by the market place and other Committees of this Congress. And certainly there are borrowers who face terrible economic hardships resulting from horrific events beyond their control. Their plight should properly be addressed with existing law, the "undue hardship" exemption. Judges may benefit from a

clearer explanation of Congressional intent in this area or more specific criteria for implementing this important protection so that those in need receive proper relief without raising costs or increasing risks for the super majority of other borrowers.

I hope this perspective is useful to you. There are two other specific aspects of the proposal on which I would like to make a brief comment. First, the bill currently removes non-dischargeability protection for loans already consummated. Retroactively re-writing a contract strikes me as simply wrong. How could any transaction in our consumer society be taken seriously if material terms could be retroactively changed by one of the parties or the United States Congress? As I noted earlier, lenders initially priced loans based on the perceived risk and mitigants including the contract's non-dischargeability. Furthermore, investors around the world who previously purchased loans in the secondary market would no doubt be injured by retroactively negating the non-discharge provisions. Preserving the sanctity of this contract law should be paramount. Lenders and investors join borrowers in relying on the Courts to judge the fairness of contracts and know that the current bankruptcy code permits a discharge of education loans resulting from undue hardship. As I suggested earlier, providing more detailed undue hardship criteria for the Courts could provide the necessary relief rather than unfairly taking a current contract right.

Second, the legislation calls for separate treatment of dischargeability for for-profit and not-for-profit entities. Maintaining the 2005 legislation's goal of identical treatment of dischargeability for private student loans – regardless of the corporate structure of the lender -- continues to make sense. Creating classes of lenders is inequitable and will lead to market place confusion. Students already face a dizzying array of choices when selecting a loan product – adding the consideration of different bankruptcy options will only further confuse students. All private student loans should be non-dischargeable.

In conclusion, I again commend the Subcommittee for undertaking this hearing. Although the proposed legislation is no doubt well intended, I am concerned that it could increase the cost of all private student loans, reduce access for some borrowers and increase the risk of unintended consequences for those who successfully discharge their loans. If the Subcommittee's goal is to protect the most distressed borrowers then I believe that clarifying the "undue hardship" standard – a current consumer protection lynchpin for student loan borrowers— is far preferable to undoing the 2005 legislation.

Thank you for considering my remarks.

I look forward to your questions.

Mr. COHEN. Thank you, sir. Appreciate your testimony.

Our next witness is Ms. Valisha Cooks. Ms. Cooks lives in Los Angeles, California, Kobe Bryant country, a single mother, and works full-time as an education coordinator at UCLA. She worked her way through Long Beach Community College and spent 1 year—1 year at Chaminade University—I guess that makes you a silver sword or something like that—before finishing her B.A. at the University of Phoenix in 2007 with a bachelor's degree in business management. She now has more than $80,000 in student loan debt, including about $53,000 in private student loans.

Ms. Cooks, thank you for coming here and telling us your—giving us your testimony and telling us about your history. Thank you.

TESTIMONY OF VALISHA COOKS, LOS ANGELES, CA

Ms. COOKS. Thank you.

Hi. My name is Valisha Cooks. When I took out private student loans, I had no idea that I was condemning myself to a lifetime of ruined credit, harassment by collection agencies, and the hopelessness of endless debt.

I assumed that I would be better off with a college degree. But after college, my loan payments were $1,150 a month; $750 of that were private loans. That amounts to more than half of my take-home pay.

I filed for bankruptcy, but that only resolved about $10,000 in other debt. Now, even though I have a good job, I can't afford to pay all my bills in any 1 month, I go to food banks to feed my son, and I will never be able to afford a house.

While my high school classmates were going to prom and playing sports, I was working full-time as a waitress and studying. I went to community college and 1 year of a private nonprofit university while working the whole time. It was a struggle, but I always paid my rent, paid my car note, and my other bills on time. I prided myself as being financially responsible.

After some time away from college, the University of Phoenix was one of the few schools that would fit my work schedule. I took out as much as I could in Federal loans, but it wasn't enough. The financial aid officer said I either had to take out private loans or drop out. I decided to stay in school. I really wanted to finish my education.

He steered me to Wachovia for a private loan and told me that it was just like a Federal loan. I knew the money wasn't free, and I only borrowed what I absolutely needed. University of Phoenix also told me that I would have 30 years to pay back the loans at a reasonable monthly rate, but that turns out it wasn't true for the private loan.

I paid the interest on my private loans while I was in school, but the interest rates rose by 0.5 percent to 1 percent every single month. That is when I realized that these were not the same as Federal loans, but it was too late. These loans seemed like the only way I could get my degree, and I thought that would make it worthwhile.

I graduated with about $41,000 in Federal loans and $36,000 in private loans. In just 3 short years, the lender for my private loans

has tacked on more than $16,000 onto my principal balance, which are now $53,000.

About 5 months after I graduated in 2007, I got a job at UCLA as an education coordinator. Shortly after that, I became pregnant. As I began to prepare for my maternity leave, my student loan bills became due. I immediately asked for forbearance or deferment.

The lenders for my Federal loans accommodated me immediately, but Wachovia repeatedly lost my paperwork for the forbearance of my private loans. They made me fax and mail it over and over, saying it was misplaced or never received or missing a date.

There was always an excuse. They were constantly transferring my calls and never let me talk to a supervisor. I couldn't get the same person on the phone more than once. I spent months trying to get a forbearance with them until I thought it finally went through.

I was diagnosed with preeclampsia and was on bed rest. My son was born 5 weeks early. He only weighed 3 pounds. Even though I thought I had my forbearance, the collection agents started calling me. Their calls started from 5 o'clock in the morning until 9 o'clock at night. This was a nightmare, and the stress made it hard for me to focus on keeping myself and my son healthy.

I had about $10,000 in other personal debt from credit cards, my car loans and medical bills. I decided to file for bankruptcy because I knew I could never pay that amount along with the mountain of student loan payments that I had.

This was not a decision I made lightly. Filing for bankruptcy was expensive and, most of all, humiliating. I was raised to work hard, pay my bills, and be responsible. My mom worked three jobs so she wouldn't have to be on welfare and raised me to be the same way.

After working hard to pay my way on my own, I could never have imagined I would have to face such a painful choice. I attempted to include the private education loans in my bankruptcy, but they were not discharged. I had already paid more than $2,000 for the attorney, and it would have cost even more for me to file for undue hardship, and my lawyer told me that I probably wouldn't be able to get it, anyway.

So after the bankruptcy, I still owed over $1,000 a month in student loans. I recently consolidated my Federal loans and signed up for the income-based repayment. My Federal loan payments went from $400 a month to $124 a month, and this is affordable for me, and I am so grateful that this program exists.

But my private education loans are in default. They are asking for more than $600 a month, and the collection agency is unwilling to give me a forbearance or take a lesser payment. I send them whatever I can afford each month—usually about $120—but they still call and threaten to send my account for wage garnishment. They refuse to negotiate an affordable plan that will allow me to repay my loans.

I live in constant fear that the hammer will one day drop and ruin my life and the hope for my son's future. It is a scary, hopeless feeling.

Bankruptcy is supposed to help manage my debt, but I am worse off now after my bankruptcy than I was before. My brother and I

tried to buy a house together, but they wouldn't allow me to co-sign a mortgage because of my bankruptcy.

I know how to build up my credit, but as long as I am in default on my private loans, that will never happen. I think part of the reason why my lender refuses to help me in any way is that they know I am stuck with the loan no matter what.

I didn't go to college to borrow a bunch of money and then shirk my responsibilities. I earned my degree to better my life and to set an example for my son, and I ended up bankrupt and still crushed by private loan debt with no way out, no light at the end of the tunnel, and no options.

Thank you for your time.

[The prepared statement of Ms. Cooks follows:]

PREPARED STATEMENT OF VALISHA COOKS

Testimony of
Valisha Cooks

Before the House Committee on the Judiciary
Subcommittee on Commercial and Administrative Law

Hearing on:
H.R. 5043, the "Private Student Loan Bankruptcy Fairness Act of 2010"

April 22, 2010
Washington, DC

My name is Valisha Cooks. When I took out private student loans I had no idea that I was condemning myself to a lifetime of ruined credit, harassment by collection agencies, and the hopelessness of endless debt. I assumed that I would be better off with a college degree. But after college my loan payments were $1,150 a month, $750 of which was for the private loans. That amounts to more than half of my take-home pay. I filed for bankruptcy, but that only resolved about $10,000 in other debt. Now, even though I have a good job, I can't afford to pay all my bills in any one month, I go to food banks to feed my son, and I will never be able to buy a house.

While my high school classmates were going to prom and playing sports, I was working as a waitress and studying. I went to community college and one year of a private nonprofit university while working all the time. It was a struggle, but I always paid my rent, my car payments, and other bills on time, and I had excellent credit. It's always been a point of pride for me to be financially responsible and independent.

After some time away from college, The University of Phoenix was one of the few schools that fit my work schedule. I took out as much as I could in federal loans, but it wasn't enough. The financial aid officer said I either had to take out private loans or drop out, and I wanted to stay in school. He steered me to Wachovia for a private loan, and told me it was just like a federal loan. I knew that this wasn't free money, and I only borrowed what I absolutely needed. University of Phoenix also told me that I would have 30 years to pay the loans back at a reasonable monthly rate, but it

I paid the interest on my private loans while I was in school, and the interest rates rose by 1% or .5% every single month. That's when I realized these were not the same as federal loans, but it was too late. These loans seemed like the only way I could get my degree, and I thought that that would make it worthwhile.

I graduated with about $41,000 in federal loans and $36,000 in private loans. In just 3 short years, the lender for my private loans has tacked more than $16,000 onto my principal balance, which is now $53,000.

About five months after I graduated in 2007, I got a job at UCLA as an Education Coordinator. Shortly after that, I became pregnant. As I began to prepare for my maternity leave my student loan bills started coming due. I immediately asked for a forbearance or deferment. The lenders for my federal loans accommodated immediately, but Wachovia repeatedly lost my paperwork for the forbearance on my private loans. They made me fax and mail it over and over, saying it was misplaced, never received, or missing a date – there was always an excuse. They were constantly transferring my calls, never let me talk to a supervisor, and I couldn't get the same person on the phone more than once. I spent months trying to get a forbearance from them, until I thought it finally went through.

I was diagnosed with preeclampsia and was on bed-rest, and my son was born five weeks early. He weighed three pounds. Even though I thought I had a forbearance, collection agents started calling me. They called from 5am to 9pm. They said they didn't know anything about my forbearance. It was a nightmare, and the stress made it hard to focus on keeping myself and my son healthy.

I had about $10,000 in other personal debt from credit cards, my car loan, and medical bills. I decided to file for bankruptcy because I knew I could never pay that back on top of the student loan debt.

This was not a decision I made lightly. Filing for bankruptcy was expensive and humiliating. I was raised to work hard, pay my bills, and be responsible. My mom worked three jobs so she wouldn't have to be on welfare, and raised me the same

way. After working so hard to pay my own way, I never imagined I'd face such a painful choice.

I attempted to include the private education loans in the bankruptcy, but they were not discharged. I had already paid $2,000 for the attorney. It would have cost even more to try to file for an undue hardship discharge, which my lawyer told me I probably couldn't get anyway. So after the bankruptcy, I still owed over $1,000 a month on my student loans.

I recently consolidated my federal loans and signed up for Income-Based Repayment. My federal loan payments went from $400 a month to $124 a month. This is affordable for me, and I'm so grateful that this program exists.

But my private education loans are in default. They are asking for $627 a month, and the collection agency is unwilling to give me forbearance or take a lesser payment. I send them whatever I can afford each month – usually about $120 – but they still call and threaten to send my account for wage garnishment. They refuse to negotiate an affordable plan that would allow me to repay my loans. I live in constant fear that the hammer will one day drop and ruin my life and any hope for my son's future. It's a scary, hopeless feeling.

Bankruptcy is supposed to help people manage their debt, but I am worse off after my bankruptcy than before. My brother and I tried to buy a house together, but they wouldn't allow me to co-sign a mortgage because of my bankruptcy. I know how to build my credit score back up, but I can't as long as I'm in default on these private loans. I think part of the reason my lender refuses to help me is that they know that I am stuck with the loans no matter what.

I didn't go to college to borrow a bunch of money and then shirk my responsibilities. I earned my degree to better my life and set an example for my son, and I ended up bankrupt and still crushed by private loan debt with no way out and no light at the end of the tunnel.

Thank you for your time.

Mr. COHEN. You are welcome, Ms. Cooks, and thank you for your testimony.

Our final witness is Mr. Adrian Lapas. Thank you. He is currently the sole practitioner at Adrian Lapas in Goldsboro, North Carolina, primarily representing individuals in consumer bank-

ruptcy cases and pursuing violations of consumer protection statutes.

Prior to opening that firm, he practiced with William Strickland and Jackson, did criminal defense, P.I.s, and general legal matters. He also served in the United States Navy, and we thank you for your service. And proceed with your testimony.

TESTIMONY OF ADRIAN M. LAPAS, ADRIAN M. LAPAS, PA, GOLDSBORO, NC, ON BEHALF OF THE NATIONAL ASSOCIATION OF CONSUMER BANKRUPTCY ATTORNEYS

Mr. LAPAS. Mr. Chairman and Members of the Subcommittee, good morning. And as the Chairman said, my name is Adrian Lapas. I am a bankruptcy attorney from Goldsboro, North Carolina.

I appear today on behalf of the National Association of Consumer Bankruptcy Attorneys, or NACBA, for short. NACBA is the only national organization dedicated to serving the needs of consumer bankruptcy attorneys and protecting the rights of consumer bankruptcy debtors.

I appear this morning in strong support of H.R. 5043, the Private Student Loan Bankruptcy Fairness Act, and I want to thank you, Mr. Chairman, for your leadership on this issue.

Most Americans see a college degree as the single-most factor for financial success. But with skyrocketing tuition and related expenses, more and more students and their families must turn to loans to pay for that education.

What borrowers are learning is that there is no margin for error when it comes to student loans. Students who choose public service or other low-paying careers or whose education does not provide the opportunities they expected to often begin their adult lives saddled with student loans they can't pay. This creates a financial black hole from which they may never escape.

I see these people in my office every day. And since the 2005 bankruptcy laws gave private student loans preferential treatment previously reserved for government guaranteed student loans, there is little that I can do to help. These loans are simply not dischargeable, except under very extreme circumstances.

Private student loans are huge profit centers for lenders, while students often find themselves loaded up with high interest rates and mountains of debt. Indeed, interest rates and fees on private loans can be almost as bad as credit cards themselves. And unlike Federal student loans, there is no limit on the size of private loans and no regulation as to their terms or cost.

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

The discharge is the fundamental purpose of individual bankruptcy. It provides the unfortunate, but honest debtor a critically important fresh start. Exceptions to the bankruptcy discharge should be carefully considered and adopted only where necessary to further other important policy choices. Because private 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 the special treatment, private student loans will become more expensive and less available. Allowing discharge in bankruptcy will not affect their availability any more than allowing the discharge of credit card debt and other private loans resulted in the lack of these forms of credit.

The private student loan industry was expanding rapidly before the 2005 amendment, and that expansion likely would have continued regardless of whether the exception to discharge can be included. And after the 2005 amendment, private student loans did not become significantly more available or offered at a lower interest rate than previously.

This suggests that there would be a minimal, if any, change in lending if the law is returned to its pre-2005 status and private student loans become dischargeable once again.

NACBA supports this reasonable and commonsense legislation to restore bankruptcy protections to private student loans. Borrowers can still be subjected to all the scrutiny and all the limitations imposed under the 2005 bankruptcy amendments, and we would urge this Subcommittee and, indeed, the full Congress to pass H.R. 5043 and help individuals and families struggling under the weight of private student loans.

Thank you for your time and your leadership, Mr. Chairman, and I would be happy to answer any questions this Committee may have.

[The prepared statement of Mr. Lapas follows:]

PREPARED STATEMENT OF ADRIAN M. LAPAS

STATEMENT OF

ADRIAN LAPAS

Goldsboro, North Carolina

on behalf of the

NATIONAL ASSOCIATION OF CONSUMER BANKRUPTCY ATTORNEYS

before the

SUBCOMMITTEE ON COMMERICAL AND ADMINISTRATIVE LAW
Judiciary Committee

U.S. House of Representatives

April 22, 2010

H.R. 5043, the "Private Student Loan Bankruptcy Fairness Act"

Mr. Chairman and Members of the Subcommittee,

On behalf of the National Association of Consumer Bankruptcy Attorneys (NACBA), this testimony is offered in strong support of H.R. 5043, the "Private Student Loan Bankruptcy Fairness Act." We thank you, Mr. Chairman, for your leadership on this issue, which is important to so many individuals and families struggling under the crushing debt of private student loans.

NACBA 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 nearly 5,000 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.

My own experiences as a bankruptcy attorney in Goldsboro, North Carolina are shared by colleagues across the country, many of whom report a growing number of people they cannot help restore to financial stability due to the treatment in bankruptcy of private student loans. Today, private student loans enjoy the same preferential treatment in bankruptcy as government-guaranteed student loans, and as such, are dischargeable in bankruptcy only in the most extreme circumstances. While there may be legitimate reasons for stringent standards for discharging debt that was financed with taxpayer funds and loaned at reasonable rates through government programs, the same cannot be said for private student loans. NACBA strongly supports H.R.5043, legislation to restore fairness in student lending by treating privately issued student loans in bankruptcy the same as other types of private debt.

Student debt

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.

It is estimated that two-thirds (67%) of all students who graduate from four-year colleges now have loans and that the average student loan debt is $23,200.[1] While most undergraduate borrowers have federal student loans, a growing number have taken on private student loans in addition to, or instead of, safer federal loans. The proportion of all undergraduate students who took out a private student loan in 2007-2008 was 14 percent, up sharply from just four percent from 2003-2004.[2]

[1] Testimony of Lauren Asher, President, the Institute for College Access & Success, before the Subcommittee on Commercial and Administrative Law, Committee on the Judiciary, U.S. House of Representatives, oversight hearing, *"An Undue Hardship? Discharging Educational Debt in Bankruptcy,"* September 23, 2009, found at http://judiciary.house.gov/hearings/pdf/Asher090923.pdf

[2] Asher.

About Student Loans

Federal student loans are designed to help ensure broad access to affordable financing for higher education and training, and 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 the federal government. Federal loan terms and conditions are set by Congress, and 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 and most expensive ways to pay for college. These loans are offered by a variety of banks and other lenders and can generate tremendous profits through high variable rates and fees. Private student loans lack the fixed rates, consumer protections, flexible repayment options of federal student loans and generally are extended base on creditworthiness. Indeed, some have observed that these loans are "not financial aid any more than a credit card is when used to pay for textbooks or tuition."[3]

Private student loans typically have variable interest rates that are higher for those who can least afforest 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 authority to increase borrower costs, such as raising interest rates in response to late payments.[4]

In addition to higher and variable interest rates, private student loans do not afford the same level of consumer protection for distressed borrowers as do federal student loans. In the case of private student loans, it is completely at the discretion of the lender as to what kind of relief is extended to a borrower having difficulty meeting the repayment terms.

The National Consumer Law Center's April 2009 report, "Too Small to Help: the Plight of Financially Distressed Private Student Loan Borrowers,"[5] found that although private lenders appear to be offering some flexible repayment options for financially distressed borrowers, they do not offer income-based repayment plans. Further, these lenders rarely cancel loans or offer reasonable settlements, even in the case of death or severe disability. 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, or if you, [i]n the lender's judgment, experience a significant lessening of your ability to repay the Loan[.]"[6] Not surprisingly, the report concludes, "lenders who make private student loans are not obliged to offer repayment modifications or relief under any circumstances, leaving borrowers truly at the mercy of their lenders."

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[3] Asher.
[4] Asher.
[5] The report is online at www.studentloanborrowerassistance.org/uploads/File/TooSmalltoHelp.pdf
[6] NCLC Student Loan Borrower Assistance webpage on "Default and Delinquency." Online at www.studentloanborrowerassistance.org/default-and-delinquency/#private

Private student loans and bankruptcy

Despite their strong similarities to credit cards and other consumer debt, private student loans today enjoy preferential treatment under the bankruptcy code. Unlike credit card debt and most other types of debt that qualify for discharge when the borrower is approved for bankruptcy, private student loans are treated like back taxes, child support, federal student loans and criminal fines, making them all but impossible to discharge in bankruptcy. Financially distressed consumers in bankruptcy must initiate a separate proceeding to handle private student loan debt, in which they have to prove to a judge that repayment of the debt would be an "undue hardship."

NACBA member Brett Weiss testified before this Subcommittee last year and made a compelling case about the arbitrary and unfair results of the uneven application across the country of the "undue hardship" test.[7] This testimony will not repeat those arguments. Quite simply, there is no rational reason to treat private student loans in bankruptcy so differently than other comparable types of debt.

The 2005 Bankruptcy Abuse Prevention and Consumer Protection Act made private student loans as difficult to discharge as federal student loans, despite the many important differences noted earlier in this testimony. There may be legitimate arguments for making federal student loans somewhat more difficult to discharge than general consumer debt, if not necessarily as hard as criminal fines. 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 financed with taxpayer dollars and are not required to provide borrower protections or affordable payment options.

Ironically, the high, unpredictable costs and inflexible repayment terms of private student loans can increase the risk of borrowers falling behind on this and other loans, leading to insolvency or even bankruptcy. So, while it may have been the egregious terms of the private student loan that caused the insolvency of the borrower, it is the private lender that is protected in the bankruptcy proceeding, putting all other creditors at a significant disadvantage.

H.R. 5043, the "Private Student Loan Bankruptcy Fairness Act"

Mr. Chairman, we applaud you for seeking to restore some measure of fairness to the bankruptcy code when it comes to student loans. There is no good reason why one type of private creditor, which is indistinguishable from other private creditors except in how the money loaned is used, should receive privileged treatment under the bankruptcy laws. People borrow money for many worthy goals, to buy food , clothing and other necessities, but that has never been reason to separate those creditors from others in terms of the bankruptcy fresh start.

[7] Testimony of Brett Weiss and Deanne Loonin, Subcommittee on Commercial and Administrative Law, Committee on the Judiciary, House of Representatives, oversight hearing, *"An Undue Hardship? Discharging Educational Debt in Bankruptcy."* September 23, 2009, found at http://judiciary.house.gov/hearings/pdf/Weiss090923.pdf

Prior to the 2005, bankruptcy law appropriately treated private student loans like credit cards and other comparable forms of consumer debt. From 1978-2005, only government issued or guaranteed student loans were protected during bankruptcy. The expansion of the preferential treatment to private loans in the 2005 law has left private loan borrowers with virtually no options for managing this type of high-risk, high-cost consumer debt.

NACBA supports your reasonable and commonsense legislation to restore bankruptcy protection to private student loans, once again placing student loan companies in the same position as virtually all other private creditors. Borrowers will be subjected to all the scrutiny and limitations imposed by the 2005 bankruptcy amendments. We urge that this legislation be adopted.

Mr. COHEN. Thank you, Mr. Lapas. You are not related to the Lapas—is it Steve, the coach of UCLA?

Mr. LAPAS. No, sir, your honor, different spelling.

Mr. COHEN. Different—oh, he had two P's, maybe?

Mr. LAPAS. I believe he spells it—yes, he does have two P's.

Mr. COHEN. Yes. I just didn't know if you and Ms. Cooks had something—anyway. Thanks. Now is the time for questioning. And being Chairman, you get to go first, and so I am first.

And, Mr. Hupalo, let me ask you a question. You were at—I believe it was Marblehead. It is a bank, right?

Mr. HUPALO. I am sorry, sir?

Mr. COHEN. Marblehead. Is that a bank?

Mr. HUPALO. First Marblehead Corporation owns banks, sir, but it is not a bank, no.

Mr. COHEN. All right. Do those banks that they own issue credit cards?

Mr. HUPALO. I am sorry?

Mr. COHEN. Do you think those banks issue credit cards?

Mr. HUPALO. No, sir, they do not.

Mr. COHEN. They don't?

Mr. HUPALO. First Marblehead does not.

Mr. COHEN. Do you know anything about folks that issue credit cards, though?

Mr. HUPALO. Just as a general consumer I do.

Mr. COHEN. Yes. And do you think that maybe they go on college campuses or used to go on college campuses and kind of encourage students to get credit cards and give them a towel or a radio or something like that to sign up to get a credit card?

Mr. HUPALO. I am not an expert in what the marketing techniques are of different credit cards.

Mr. COHEN. Let's just assume—let's assume that happened in America, that they went on college campuses.

Mr. HUPALO. There are newspaper reports that that has happened, certainly.

Mr. COHEN. Yes. And so if they did that, those students don't have any better way—they are in the same situation getting those credit cards as they are in getting these loans that you all make, and they are out and don't necessarily have a job or a bunch of capital to be surety or collateral for loans, and yet the banks are really looking for them as prime prospects. Should they be—have a different system written into the law to where those credit cards given to college students aren't dischargeable in bankruptcy?

Mr. HUPALO. Again, sir, I am not an expert in credit cards, but I have to tell you, I disagree vehemently with the idea that a credit card and student loan are comparable assets.

Mr. COHEN. Why not? If what your argument is, that the reason they should be non-dischargeable is because these students go and they don't have much money—and I know they are paid back over a long period of time——

Mr. HUPALO. Yes, sir.

Mr. COHEN [continuing]. But they don't have much money, and they don't have a whole lot of collateral, a whole lot of assets, they just got some potential, that is the same thing with credit cards, isn't it? How do you distinguish that?

Mr. HUPALO. I will be glad, if I could spend a few moments talking about that, which I think is a really important question that you are raising, sir. The difference between a credit card and a student loan is fundamentally different. They share two common

traits. One is that they are credit underwritten. And the second, of course, is that they are unsecured consumer assets, debt, rather.

Other than that, though, the similarities are vacant for me. First, on a loan, lenders ask to make a commitment that the borrower asks for on day 1 for some period of time, perhaps 20 or 30 years in the future.

When a student applies for a credit card, the credit card lender will say, based on your credit profile, I will lend you—or I will make a line of credit available to you for $500 or $1,000 or whatever it might be, but they can limit that on that very first day. A student—a borrower doesn't have a say in how much credit card exposure they get. The bank sets that.

The second, sir, is that there is a long-term commitment, again, on a student loan or any loan. The credit card is a short-term commitment. And if the borrower has difficulty paying, if they miss a payment, the credit card companies have opportunities to mitigate their risk that a student loan issuer does not have, a bank, and that specifically is the idea that they can stop the credit.

So if I have a $5,000 limit on my credit card and I am delinquent, I am going to get a note from the credit card company saying, "Your limit is now $2,000 or $1,000," or whatever that balance might be, "and I am going to take other actions to try and collect that debt more rapidly."

Mr. COHEN. Slow down for a minute, because you are in my 5 minutes, and we have—and I appreciate it. But you sound more of an expert on credit cards than you started out. You know, and so obviously, you know, I hit a question that you were prepared to answer, so you boned up on the subject.

Mr. HUPALO. Well, I think a lot about these things, sir.

Mr. COHEN. What if we changed the credit card law and said that they could pay it back over a longer period of time and took that into consideration, because they were just right out of the, you know, nest and didn't have any job and income and stream and a home and all those things? Would then—should they be dischargeable?

You know where I am getting at. Why should—why are your debts different from all other debts, going back to recent holidays?

Mr. HUPALO. I can talk a little bit more about that than what you should do with regard to dischargeability of credit cards.

Mr. COHEN. Good. Let's move on to that subject.

Mr. HUPALO. So I think the answer, sir, is that the student loan is a unique asset. It has all the attributes that we have talked about. And lenders do not have an opportunity after that first loan is made to go back and work with a borrower on these other programs of reducing their risk.

The loan has been made. And, believe me—I think Mr. Franks said it correctly—I have been in the industry a long time, and there is deep care for borrowers across the country. And if you look at the norm that the average borrower has a good experience with a private student loan, and I am afraid that the atypical experience is the one that we talk more about.

Mr. COHEN. Ms. Loonin, just like "Saturday Night Live" when they had, you know—respond.

Ms. LOONIN. Well, I mean, I think that, first of all, the first point about—you know, comparing to credit cards, really, a student loan is actually much more like a credit card, other than this sort of open-end versus close-end argument, and that is that the lender has the ability to assess, a reasonable ability to repay, and underwriting at the outset, whether it is a student loan or whether it is a credit card, and choose to evaluate the risk at that point, and that is what the private lenders are doing now.

They are making these loans much—every loan has some element of risk, but they are taking a lot of the risk out of them by requiring underwriting and other things. And that way there is less likely to be the same level of write-offs as others.

So in that sense, there is nothing really unique in whether—you know, in what the incentives are for creditors to make the loans. The private loan creditors are making—or were making a lot of money on these loans for a long time, so obviously they had the incentive to make them.

Mr. COHEN. And what about the—did you all characterize some of these possibly as kind of subprime?

Ms. LOONIN. Absolutely. I mean, there is every—and we did a report a couple of years ago which is on our Web site—welcome to look at it—but all of the features of subprime lending, including the failure to assess reasonable ability to pay, so poor underwriting, irresponsible lending, high fees, origination fees up to 10 percent, APRs up to—all variable rate, 15, 20 over that percent.

Basically, the most vulnerable borrowers are the least likely to be able to repay the loans, and they are the ones who are hurting the most.

Mr. COHEN. And in essence, our system where we have this nondischargeability in bankruptcy, Ms. Cooks has got nothing—she has got no relief, does she? What is Ms. Cooks' relief? Any at all?

Ms. LOONIN. Well, that is—and that is what I mentioned. What I do—call the creditor and see what they will do. And she mentioned that a little bit with Wachovia, that she had trouble reaching them in the first place. I am able to reach them. I am not here to complain about that. I have contacts with a lot of the creditors. They are respectful. But they look at my clients' profiles and they say, "There is nothing we can do for them."

Mr. COHEN. And is there nothing they can do for them? I mean, you can't discharge in bankruptcy, so what can you do? I mean, you can—you can just pay it off the rest of your life or you can slit your wrists?

Ms. LOONIN. Well, there is something the creditors can do. They can choose to work with the borrowers. And I think, frankly, in some cases, that might be even worth their investors—worth—you know, might make some value, because that way—instead of writing them off and getting nothing, they might be able to work out some agreements and be more flexible, modify the terms, do some things where maybe there is some possibility of getting some cash flow from these borrowers.

In some cases, the loan is so expensive it was destined to fail, there really is nothing to do.

Mr. COHEN. With the indulgence of the Committee and the prerogative of being Chairman, I am going to ask Mr. Hupalo, is there

some type of a modification of the law that you could see that would be beneficial to the student and yet leave your—your business ventures whole?

Mr. HUPALO. Yes, sir, I think there is. And one of the recognitions that we all should have is that the private student loan industry has really developed over the course of maybe the last 5 to 7 years in significant volumes and that we have gone through an interest rate cycle and a—and a global financial calamity that really has changed the face of finance, and you all know that as well as anyone.

The specific answer to your question, I think, is that the market will evolve. I think that there are a lot of lessons learned from the mistakes that were made by lenders and by borrowers, frankly, over the course of the last 5-or 7-year period, and I think there will be financial innovation that will come out that will make these products more accessible, the underwriting criteria will be better, the data that is in place in the pools now will inform how we keep borrowers in a position where they can make comfortable payments over time.

One thing that I think about is that—like, in the—when you take your vacation, you can buy trip insurance. Perhaps the market will evolve to a place where lenders will offer borrowers upfront opportunity to buy insurance against the loss of a job for a period of time or against the bankruptcy filing or something of that nature.

But my point before, sir, was that there are borrowers on both ends of the spectrum—those who take these private student loans, get their degrees, and repay them very quickly. There are other borrowers, unfortunately, on the other side who have the difficulties as we heard today, and this is heartbreaking testimony to hear these, but those are—both borrowers are atypical.

The students and the majority of them in the middle can take private student loans, they go to school, they get their degrees, they get a job, and they make their repayment on time. The data shows that the overwhelming majority of these borrowers have successful experiences with private student loans, and I think the market will help other borrowers as time goes on.

Mr. COHEN. And, Mr. Hupalo, I am going to go on a little bit more, but your answer basically is to what Mr. Franks would have normally been asking you, about the free market. What I asked you, is there legislation that you think could be proposed or offered that might remedy some of these problems?

Mr. HUPALO. I can't offer any comment on that, sir.

Mr. COHEN. You could. You just don't—you either don't have any—you don't have—you don't have a thought on it?

Mr. HUPALO. I haven't thought about it, sir.

Mr. COHEN. Okay, thank you.

Mr. HUPALO. Thank you.

Mr. COHEN. I will yield to Mr. Franks, and thank you, sir.

Mr. FRANKS. Well, thank you very much.

And as always in these discussions, you know, there is a desire on the part of policymakers to try to create the kind of atmosphere that will incent people and the system to—to allow people like Ms. Cooks to gain a college education. And that is something I desperately want to see happen.

The challenge is that oftentimes with legislation like this we never take into consideration that—Ms. Loonin was correct, that sometimes people make these loans because they believe they are going to make some money doing so. And if you take that out of the equation, they will simply stop making the loans. And the result will be the next person, like Ms. Cooks, that comes along will not be able to gain a college education.

And I—it is always hard as a conservative to make those arguments, because it seems like it lacks the heart, but I really believe that it is the most heartfelt argument that I can make.

If we want to make this work, we cannot repeal the laws of mathematics. And the idea that we will, you know, wipe out the private industry in favor of government and the nonprofit industry, we don't realize how much those other two entities depend upon the private market.

If the private investment, the private individuals, private endeavors fail, then government will have nothing to give anyone anything, and certainly nonprofits are largely dependent upon the private market, as well.

So my concern is that we are going to be successful here at some point in chasing private capital out of the market. And when we do that, we will not like the result.

So, Mr. Hupalo, the total volume of private student loans dropped 52 percent for the 2008-2009 school year. And according to the Wall Street Journal, this is because private lenders—private student lenders are having a difficult time raising the capital from investors necessary to make student loans.

Could you explain why it is likely that H.R. 5043 will both further decrease the availability of private student loans and likely cause lenders to raise the interest rates they charge, like happened with credit cards when we messed with credit cards?

Mr. HUPALO. Yes, sir. Thank you. And I touched on it briefly in my verbal comments earlier and the written testimony I provided, and that is that the—although the recent experience in the—in the credit markets has masked, I think, a lot of the underlying tendencies that occur with consumers, because interest rates have been at historic lows, it is hard to make a judgment looking from 2005 to 2010 to have a cause and effect of what the 2005 legislation did to consumers during the period of 2005 to 2010, because it was just so absent, particularly the second half of that period.

And so my concern, though, sir, is after working in this industry for quite a long time, is to know that as a risk-based product, which this is, and it is risk-based Federal Government loans or risk-based loans, as well as a private loan, as well as loans that are offered by not-for-profits, at the end of the day, you need to have a positive return, as you said, in order to offer additional loans.

If it comes to a point where access is denied because cost is too high, or the credit criteria become too tight that borrowers are not able to avail themselves to this kind of a loan, then the reality is that there will be a reduction in access to school and borrowers will not be able to go to the school that they choose, but they may have to go to another institution.

So I think there are multiple potential effects that would be negative if this were to go forward.

Mr. FRANKS. Well, obviously, I agree with that and, in my opening statement, said that H.R. 5043 seems to be an overly broad attack on all private student lenders, rather than a nuanced approach aimed at abusive lending practices. So I guess I would ask you again, Mr. Hupalo, in your experience, is the private student lending industry so dominated by unaffordable loans that we need bankruptcy legislation that affects the entire industry?

Mr. HUPALO. Sir, thank you for the question. And as I tried to indicate in my response to the Chairman earlier, the—when you look at the population, a spectrum of private student borrowers and the spectrum of private student lenders, you realize that it is quite wide and it is broad.

And the reality is that, if you go to the norm, take away the tails of very, very successful student who repays immediately and the poorer borrower who has a multitude of very unfortunate incidents and circumstances as we heard this morning, those out of the equation, the sweet spot, if you will, of the data tells you that the borrowers are successful, they can repay these loans if they are created properly, they are able to achieve their dream of a college education as a result of the prudent use of private student loans. And so I don't believe that every student should have access to a private student loan.

Mr. Cohen talked about the scholarship program in Tennessee. They should take advantage of those. They should take advantage of all the other grant opportunities, educational funding that comes from the school, then the Federal loan programs, which are absolutely essential. And then if they need more money and they want to go to that school, a private student loan would be the right place for them to shop.

Mr. FRANKS. All right. Well, thank you, Mr. Chairman. Thank all of you for being here.

Mr. COHEN. Thank you, sir.

I now recognize Mr. Johnson for 5 minutes.

Mr. JOHNSON. Thank you, Mr. Chairman.

Ms. Loonin, you referred to these private students loans as subprime lending. Would it be fair to also characterize these loans as predatory loans in a predatory lending atmosphere?

Ms. LOONIN. Yes, I mean, not all of them, but certainly that was a segment of the industry, and I would say, mainly because, similar to what we think of as the predatory mortgage loans, a lot of these loans were made not so much for the purpose of what is best for the borrower, but for the purpose of, how soon can we package them and get them sold to investors?

Mr. JOHNSON. Okay, now stop right there.

I wanted to ask that question—and I will ask it of Mr. Hupalo. Isn't it true that these private student loans are bundled and then sold as securities on Wall Street?

Mr. HUPALO. Some of them and perhaps a majority of them were, but no longer as a result of the credit crisis.

Mr. JOHNSON. And that is why the lending activity declined in 2008 and 2009, isn't that correct?

Mr. HUPALO. Yes, sir. That was a large component of the decline.

Mr. JOHNSON. And, in fact, it may have even been a large component of why our economic system was on the verge of collapse in October of 2008. Isn't that a fact? Yes or no?

Mr. HUPALO. No, sir, I don't think—I don't think that is as it is a fact.

Mr. JOHNSON. Okay, well, let me—let me move forward then, and I am sure that you would not disagree with that, Ms. Loonin, but let me talk with Ms. Cooks. And I think you are the American success story in terms of working your way through high school and then through college.

And tell me, did you see an advertisement for your private student loan or did someone steer you to the private lender?

Ms. COOKS. I was steered toward Wachovia specifically. There wasn't——

Mr. JOHNSON. And who——

Ms. COOKS. The financial aid officer at the University of Phoenix, there wasn't like a paper given to me with a bunch of options that I could shop for the best rate. There was one person on the list, and that is who we used for our alternative loan.

Mr. JOHNSON. Now, do you know whether or not there may have been a connection between the loan officer and the lending institution?

Ms. COOKS. I am sure that is a possibility. I personally don't know. But——

Mr. JOHNSON. But you know—you did not know at the time that you took this loan, either, I suppose.

Ms. COOKS. Right.

Mr. JOHNSON. And so you were steered to one lender. You were told that you were not eligible for a——

Ms. COOKS. There were no——

Mr. JOHNSON [continuing]. Federal student——

Ms. COOKS [continuing]. Scholarships or—I applied for all the other things.

Mr. JOHNSON. Did that same student loan official tell you that you were disqualified?

Ms. COOKS. Actually, no, they didn't even give me the option. It was something that I researched on my own, and I was denied, they said, based on need base, that other people needed it more than I needed it, and there wasn't any other——

Mr. JOHNSON. So nobody told you that? That was just your own——

Ms. COOKS. Right.

Mr. JOHNSON [continuing]. Finding? It could have been right or could have been wrong.

Ms. COOKS. I have always kind of researched a lot of things on my own.

Mr. JOHNSON. Yes, well, you sound like a very smart young lady.

Mr. Lapas—well, let me go—before I ask you, let me go back to Mr. Hupalo and ask whether or not private lending of student loans is restricted to only nonprofit entities?

Mr. HUPALO. It is not restricted, sir.

Mr. JOHNSON. So a for-profit school or a nonprofit school would qualify to—for the exemption under current bankruptcy law as a private lender? Is that correct?

Mr. HUPALO. The loan, sir, would not qualify, that is right.

Mr. JOHNSON. So this means that, if I decided to go out and set up the Hank Johnson Bible College in a one-room office, I could be qualified as a student—as a private student lender?

Mr. HUPALO. You would need the capital, sir, to do that.

Mr. JOHNSON. What kind of capital would I need?

Mr. HUPALO. You would raise capital privately, perhaps.

Mr. JOHNSON. But I could open up a non-accredited institution and still get the benefit of the exemption under current bankruptcy law?

Mr. HUPALO. No, sir, you would have to be a regulated lender. So in your example, sir—I understand what——

Mr. JOHNSON. Yes, I could be like a loan broker, let's say, and write the loan on behalf of, let's say, Wachovia, and, boom, have Wachovia as the registered entity that is making the loan officially.

Mr. HUPALO. You could ask Wachovia to make loans available to your students. Yes, sir, you could.

Mr. JOHNSON. This sounds like a giant cesspool of muck that contributed to a financial system decline, and there are even people who say that Wall Street is doing—is back to doing the same thing that it was doing prior to the meltdown, and perhaps the private student loan industry is a major contributor to this.

So I believe that this legislation is needed and necessary. Mr. Lapas, I am so sorry that I didn't have a chance to ask you some questions about this.

Mr. COHEN. Mr. Johnson, you may have that opportunity. I am going to ask you to take the Chair, as I have got some business to attend to. And with the prerogative of the Chair, before you recognize Mr. Coble, you might be able to ask another question, but I appreciate it. I could see Rahm Emanuel channeling through you, and I appreciate your ability to ferret that out.

Mr. JOHNSON. Thank you, sir.

Mr. COHEN. So if you would take the Chair for a minute, please.

Mr. JOHNSON. [Presiding.] All right. We will next go to Mr. Howard Coble, the Ranking Member of the Courts and Competition Subcommittee of the Judiciary Committee.

Mr. COBLE. Thank you, Mr. Chairman. Good to have you all with us, especially my fellow Caroline from eastern Carolina. Mr. Lapas, good to have you here.

Mr. Hupalo, will lenders shy away from originating private student loans if the borrower can file for Chapter 7 after graduation and fully discharge the debt?

Mr. HUPALO. Sir, they will either change their credit criteria or likely increase the rate charged to offset the increased risk of that discharge of—in bankruptcy.

Mr. COBLE. Mr. Lapas, assuming for argument's sake—and I am not suggesting this one way or the other—but assuming for argument's sake that private student lenders are engaged in predatory lending practices, is not amending the bankruptcy code an indirect way to get at predatory student lending?

Mr. LAPAS. Mr. Coble, I really cannot speak to that.

Mr. COBLE. Pull the mic a little closer to you, Mr. Lapas, if you will.

Mr. LAPAS. I cannot speak to that. I do not know, but amending the bankruptcy code for debtors that are in financial distress would be the most efficient means of dealing with that debt, much as in Ms. Cooks' situation, as opposed to attempting some type of private litigation to address any predatory practices on behalf of the student lenders.

Mr. COBLE. Let me ask you this, Mr. Lapas. Am I pronouncing, Mr. Lapas, that correct?

Mr. LAPAS. That is correct, sir.

Mr. COBLE. Some of the testimony today is that private student loans are more akin to credit cards. Of course, we all know the fundamental difference between the two. Credit cards, of course, are issued based upon the current ability to repay, whereas the student loans are based upon future ability to repay. What steps outside of bankruptcy can the Congress take to make private student loans more like Federal student loans and less like credit cards, if you know?

Mr. LAPAS. I would not hazard a guess on that.

Mr. COBLE. Would any of the members of the panel have——

Mr. LAPAS. Perhaps Ms. Loonin would be more appropriate to answer that.

Mr. COBLE. Okay.

Ms. LOONIN. Sure. I think Federal student loans really are truly much more like financial aid. And the government guarantees payment of them, so I suppose that, you know, is something that could be done, but I think that is exactly—that is not a step we would want to take, because, you know, the market—the point about the Federal loans is it is not just that the government guarantees them, but there is also strict regulation of rates and terms and all the flexible options out there.

Mr. COBLE. I thank you for that, Ms. Loonin.

And let me ask any of the panel members this. Are you all concerned that making private student loans unconditionally dischargeable in bankruptcy may negatively affect access to future loans? Does anyone have any concern about that one way or the other?

Ms. LOONIN. No, because there is no evidence that that is what the lenders are responding to. As we said, they are responding to market incentives. And to the extent that private loans are less available now, we consider this a welcome market correction, because it is primarily the very high rates, predatory loans that have astronomical write-off rates, those are the ones that are being made less now.

And the other, more responsible lending is continuing to go on, which, frankly, responsible, prime, private lending is not where the problem is. We are—there are some lenders that are trying to step in now to fill in the gap, so I am not saying that the situation is going to stay, but that is the way it is right now.

Mr. COBLE. Mr. Hupalo, want to weigh in?

Mr. HUPALO. Yes, I would have concern that there would be access problems. And, again, the idea of trying to document this over the last 5-year period is very difficult, given all the market turmoil that has occurred.

Mr. COBLE. Mr. Lapas, want to insert your oars into these waters?

Mr. LAPAS. Yes, sir, but also, over the last 5 years, it has only been for the last 5 years that private student loans have been non-dischargeable. Prior to that time—which would be a relevant time period to look at—what has been the access to private student loan lenders while those debts were dischargeable in bankruptcy? Just to reiterate, it is only since 2005 that private student loans were non-dischargeable in bankruptcy.

I do not have that concern that access would not be available. And as Mr. Hupalo indicated in his prior testimony, there is a small tail of student borrowers that are not paying, so that that sweet spot, the middle, where most borrowers do pay, is still going to provide the impetus for that access to capital.

I believe the statistics would show—and, again, Ms. Loonin may be more expert than I on this matter—but that the amount of debt even considered in bankruptcy for student loans—private student loan lenders is miniscule in respect to the overall market.

Mr. COBLE. Ms. Cooks, you want to weigh in on this?

Ms. COOKS. On your previous question that you asked, what do I think should be done, possibly just options, because like I said now, I don't really have very many options. With the Federal loans, of course, I have the IBR, the income-based repayment option. Now I send my private loan lenders what I can afford.

So if there was a similar type of option with the private loans, where they were forced or held to the same standard as the Federal loan, to give me an affordable monthly payment or even a length of period that I could defer the payment, and continue to pay interest, or just any type of options.

Mr. COBLE. I got you.

Ms. COOKS. Because now I continue to pay my loan even though they are in default. I just can't afford to pay what they are asking me to pay.

Mr. COBLE. Thank you, Mr. Chairman. I see my red light has illuminated. Mr. Chairman, one final point. And I don't think anybody has mentioned this.

One of the—maybe the appropriate word might be culprit—is the increasing cost of education. That is one of the—I don't—I don't have a handle on that, but if you all do, meet me after class. I will be glad to listen to you.

Good to see all of you. Thank you, Mr. Chairman.

Mr. JOHNSON. Thank you, Mr. Coble.

Next we will hear from the gentlewoman from California, Ms. Judy Chu.

Ms. CHU. Thank you, Mr. Chairman.

I would like to ask questions pertaining to this premise that there would be a widespread abuse of bankruptcy should the law be changed. And, of course, we know that in 2005, Congress limited the discharge of private student loans through bankruptcy, only for when the debtor could show undue hardship, and the change was made because of this premise of widespread bankruptcy should private loans be dischargeable.

So, Ms. Loonin, what do you believe about—what do you think about that? I know that there was a recent nationwide study which

shows us that nearly half of all debtors seeking to discharge education debt through bankruptcy had incomes at or below 200 percent of the Federal poverty level. Would there be widespread abuse of bankruptcy, should this occur?

Ms. LOONIN. Yes, thank you. That was the original premise for the Federal student loan non-dischargeability without even evidence that there was that sort of heightened filing by students in the Federal loan program. There is certainly no evidence that that is true in the private loan program, so it is based on a false premise, and I think really, you know, missed—or, you know, mischaracterized the reasons why people file for bankruptcy.

The people file for bankruptcy, as the evidence shows, because they have to, because they don't have income or because something has happened in their life, a medical situation or something like that, that requires them to get this fresh start.

So, again, I don't think that that is something that should be concerned. We can—Ms. Cooks spoke to the consequences of bankruptcy, the effect on the credit report, the fact that this stays on your credit report for 10 years. The other consequences of bankruptcy are things that I hear from my clients every day when they consider whether they even want to think about filing for bankruptcy.

Ms. CHU. Mr. Lapas, what was the situation prior to 2005? Was there widespread abuse of this process with student loans?

Mr. LAPAS. With regards to private student loans?

Ms. CHU. With regard to private student loans.

Mr. LAPAS. Not in my——

Mr. JOHNSON. If you would put your mic on, also.

Mr. LAPAS. Not in my day-to-day practice. I rarely saw instances with private student loans where the debtors were attempting to in essence game the system. They all had serious financial issues that needed to—needed to be addressed.

Most of the time, the precipitating financial problem that caused them to seek bankruptcy assistance in the first place was not the student loan, but that compounded it. And in discharging a private student loan prior to 2005, it would help the debtors get back on track, but it was not the main factor most times.

And, again, prior to 2005, if there was someone with student loans, significantly, they were the government guaranteed student loans or loans issued by nonprofit, which were non-dischargeable, anyway.

Ms. CHU. Current law says that private student loans can't be discharged unless there is an undue hardship. What is the difficulty in considering that approach?

Mr. LAPAS. Undue hardship is largely defined as—and particularly with regards in my circuit, the Fourth Circuit, as a certainty of hopelessness. Not only do you have to show that you can't afford to make the payments, but that you have to show that you are not going to be able to make the payments for an extended amount of time.

Recently, a Fourth Circuit case came down where the debtor was offered—on Federal student loans—an income-based repayment plan that would extend for 25 years, 25 years, and that was considered a reasonable accommodation. And because she declined that

25-year-based repayment plan, the court held that we are not going to discharge your student loans. Again, these were the Federal student loans.

Also, one of the difficulties is the cost to the debtor of even attempting to get the debt discharged in bankruptcy. And, again, going back to my circuit, the Fourth Circuit, another case recently was handed down where the debtor filed an adversary proceeding to have her loans discharged in bankruptcy court. She won in bankruptcy court. The creditor appealed it to the district court. The district court remanded it back to bankruptcy court.

They held another hearing. The bankruptcy court ruled in favor of the debtor. She won again. It goes to the district court. She wins. It was appealed to the court of appeals on the Fourth Circuit. She loses.

So you have got a 3-year timeframe in which not only is she hanging in limbo, but she is incurring additional attorney's fees, other costs associated with it. She wins all the time, up until the Fourth Circuit, and she loses, in another case where the debtor wins up through the Fourth Circuit and loses yet again.

Most debtors cannot afford to do that. They cannot afford to take that chance. They cannot afford to incur the attorney's fees to do that. Or the attorney just takes it for free.

But it is not only just for free in that the attorney will be advancing significant costs of their money to pursue the case further.

There are significant hurdles with that undue hardship. Again, we are not here to discuss undue hardship. It is just changing the bankruptcy code to allow for the discharge of private student loans. But, again, that is a significant factor.

Prior to 2005, government loans—well, private student loans were dischargeable. After 2005, they just simply are not. The undue hardship does constitute a significant hurdle.

Ms. CHU. Thank you.

Mr. JOHNSON. We have been joined, ladies and gentlemen, by my good friend from the great state of Ohio, Congressman Jim Jordan.

Mr. JORDAN. Thank you, Mr. Chairman. And I apologize for missing your testimony. Actually, I went back to my office to meet with the Ohio State Bar Association.

Mr. Hupalo, will this change fully dischargeable private student loans? Isn't it just going to add to the cost of people who—future borrowers, I mean, when lenders have to assume this risk, they are just going to—it is just going to mean students who want to borrow money to pay for their college are going to have pay more in the future?

Mr. HUPALO. Yes, sir, thank you for the question. And perhaps we should draw the line a little finer.

Prior to 2005, private loans made by not-for-profits were non-dischargeable. So the 2005 legislation put all of the loans made by for-profit lenders and not-for-profit lenders on the same footing, so there is some equity put into the system at that point.

To your question, sir, yes, we talked before about the tails of students who are able to pay and those who are unable to pay, and then the large majority in the middle. I believe, sir, that the cost will increase for all borrowers in the—and particularly those that will bear the costs in the middle, those who are paying on time.

Mr. JORDAN. Okay, let me ask you a slightly different question. The provision put in the health care bill, which, you know, vastly moved the government direct lending in the student loan market, do you think that will lead to greater defaults? And, I guess, country boy from Ohio is thinking, if a student and a family are getting a loan from their local banker or someone they know, less likely to default than if they are getting it from the—you know, the big, bad Federal Government, and somewhere else.

Do you think—so do you think the change made in the health care bill is actually going to mean more defaults from students as we move forward?

Mr. HUPALO. Sir, I don't—I can't really give you a view on that. But I do know that, you know, there is a lot of language—relative language that we talked about this morning about loans being riskier or costlier, and trying to quantify that is sometimes difficult.

But what should be known is that the Department of Education released in December 3-year default rates. This is now a change in their methodology that shows that the 3-year default rates for Federal loans are in excess of 11 percent, with some of them as high as 20 percent.

So when we talk about private student loan default rates and Federal Government student loan default rates, I want to make sure that we are on an even footing and to try to identify where those relative measures are and what they are.

For instance, you know, we talk about cost of loans. Today's interest rate environment leaves it such that borrowers with variable rate private loans may, in fact, be paying less than they would pay on their Federal Government fixed-rate loan. It is the nature of the interest rate environment.

Mr. JORDAN. Right.

Mr. HUPALO. But all these questions need to be answered.

Mr. JORDAN. Yes. Is it fair to conclude, as I have, that this—the bill we are talking about today, the action that was taken in the health care bill, that the current majority in Congress and this Administration simply want the government to do it all when it comes to student loans?

Mr. HUPALO. I believe that is right.

Mr. JORDAN. Okay.

Thank you, Mr. Chairman.

Mr. JOHNSON. Thank you, sir.

Next, the distinguished gentleman from the great state of Virginia, Mr. Bobby Scott.

Mr. SCOTT. Thank you. Some of this may be a little bit repetitious, but let me just get some things on the record.

Mr. Lapas, the private loans and direct Federal loans are both equal in terms of bankruptcy, both non-dischargeable, except in hardship. Is that right? They are treated equally?

Mr. LAPAS. That is correct.

Mr. SCOTT. In bankruptcy. Now, on the Federal loans, you can get deferrals for many reasons, like public service, continuing your education, and things like that, is that right?

Mr. LAPAS. That is correct.

Mr. SCOTT. Can you do that on private loans?

Mr. LAPAS. Generally no. That would be up to the individual private student loan lender and whatever individual policies they may have in place. It would certainly be in the lender's discretion.

Mr. SCOTT. Now, in Federal loans, are you entitled to an income-based repayment plan that is a percentage—a reasonable percentage of your income?

Mr. LAPAS. That is my understanding, yes.

Mr. SCOTT. And is that available under the private loans?

Mr. LAPAS. Again, it would be in the discretion of the private lender.

Mr. SCOTT. But you are not entitled to it?

Mr. LAPAS. But you are not entitled to it.

Mr. SCOTT. Mr. Hupalo, can you—you were talking about default rates. What is the default rate on the public loans and the private loans?

Mr. HUPALO. I stammer, sir, because that is a very broad question. I think you are looking for a very narrow answer. You can look, you know, generally across default rates, and they vary by lender, by borrower type, by school type, so I could perhaps give you a better answer in the future.

Mr. SCOTT. Is there a difference in interest rate charged?

Mr. HUPALO. Yes, there is, sir.

Mr. SCOTT. What is the—what is the difference in interest rate charged between public and private loans?

Mr. HUPALO. Generally, the public Federal Government loans are fixed-rate loans, and their percentage varies. The answer for private-sector loans, the bank-type loans, are variable rate. When the variable rate is based on an index and then based on the creditor's borrower, there is an addition to that index called the spread, and that varies.

Mr. SCOTT. What are some of the kinds of interest rates that private loans are charging now?

Mr. HUPALO. Private loans currently can charge—you know, for instance, I can tell you, based on some of my experience and knowledge of some of these portfolios, something on the order of LIBOR plus 4.75 percent or 5 percent, which in today's interest rate environment would be somewhere on the order of 5 percent to 5.25 percent.

Some of those—that is for—that is an average. And, again, we need to be careful, because there is certainly loans that are LIBOR plus 10 percent, and there are loans that are LIBOR plus 3 percent, so we need to be careful about our language.

Mr. SCOTT. Ms. Loonin, for those that are in trouble, what kind of interest rates are they being charged?

Ms. LOONIN. Well, I see a wide range, but for the borrowers I see who are in the most trouble, the interest rates are usually, again, variable, but at least 10 percent, and then generally as high as—I think the average in the study I did was 11.5 percent, but I have seen, as I have said, over 20 percent, as well.

Mr. SCOTT. Ms. Hupalo, in 2005, the change was made to make private loans, which were then dischargeable, non-dischargeable, except for hardship, is that right?

Mr. HUPALO. Yes, sir.

Mr. SCOTT. Did that apply to existing loans?

Mr. HUPALO. I don't believe so, although I am not an expert on that.

Mr. SCOTT. Ms. Loonin, did it apply to existing loans?

Ms. LOONIN. Yes, it was for cases filed after that date, correct.

Mr. SCOTT. Okay, now, does anybody have any evidence as to whether or not the interest rates went up, the default rates went up, or anything good or bad happening after the 2005 change to private loans?

Ms. LOONIN. I have some information—that Sallie Mae, for example, the average margin on their private student loans continued to increase, starting from before the change and then through 2007 after the change, as well.

Mr. SCOTT. So that you could not—the change did not have an effect on interest rates or default rates?

Ms. LOONIN. Correct.

Mr. HUPALO. May I, sir? I think that the non-dischargeability question is one of a number of factors when you are pricing a loan, so there may have been other factors included in that, including the potential for going down the credit scale, which some lenders did do.

Mr. SCOTT. Well, if there wasn't much effect when we added it, why would there be much effect if you took it out? If you went exact to how things were before 2005, why would there be much of a difference?

Mr. HUPALO. Because, again, I don't know how much of a difference there would be, but there would be some difference, because the lenders would look at the experience that they have had and price in what they think will be the increased bankruptcies in that forward period.

Mr. SCOTT. When the loans were, in fact, dischargeable, were students, in fact, filing for bankruptcy? What was the experience?

Mr. HUPALO. Perhaps Mr. Lapas can tell us that.

Mr. SCOTT. I mean, they could theoretically—I mean, as Mr. Hupalo indicated, they were essentially asset-free and heavily in debt, and that is an invitation for bankruptcy. Did they, in fact, take advantage of it or not?

Mr. LAPAS. Well, the decision to file bankruptcy is certainly an individual decision. And as I indicated to Ms. Chu, there are a lot of other factors involved in the decision to file bankruptcy.

On an anecdotal basis and based just on my practice, do people come in with student loan debt or particularly private student loan debt solely to file bankruptcy? I cannot recall a single one solely that came into file bankruptcy in that respect. But they were certainly part of the debt picture which led to that decision to file bankruptcy.

Mr. SCOTT. So, Mr. Chairman, I just want to end up by saying, if although theoretically they could be filing bankruptcy, if that wasn't the actual practice, and we see situations like Ms. Cooks', it seems to me that we are afraid of something that just wasn't happening.

And so unless we see evidence that—of something happening, I think we are—it is just theoretical. There wasn't any change after 2005 that is apparent, so I yield back.

Mr. JOHNSON. Thank you, Congressman.

Mr. JORDAN. Mr. Chairman?

Mr. JOHNSON. Yes?

Mr. JORDAN. I would just unanimous consent if we could enter the written statement into the record from the Consumer Bankers Association.

Mr. JOHNSON. Without objection.

[The information referred to follows:]

Testimony Submitted by the Consumer Bankers Association

For the Record of the Hearing on H.R. 5043,

The Private Student Loan Bankruptcy Fairness Act of 2010.

United States House of Representatives

Committee on the Judiciary

Subcommittee on Commercial and Administrative Law

April 22, 2010

Leaders In Retail Banking | 1000 Wilson Boulevard Suite 2500 Arlington, VA 22209-3912 **Tel** 703-276-1750 www.cbanet.org

Chairman Cohen, Ranking Member Franks and the Members of the Subcommittee, thank you for the opportunity to submit testimony regarding H.R. 5043, the Private Student Loan Bankruptcy Fairness Act of 2010. This testimony is submitted on behalf of the Consumer Bankers Association[1] ("CBA"). It reflects the views of CBA's Education Funding Committee, a committee of financial institutions active in both the federal and non-federal student loan market.

In considering Chairman Cohen's bill, we note this legislation will effectively repeal a change made in the Bankruptcy Abuse and Consumer Protection Act of 2005, the broad, bi-partisan legislation that modernized the bankruptcy system in the United States. That change was made in order to broaden the availability of non-federal student loans at lower costs to borrowers. The bill would make education loans by for-profit companies again completely dischargeable in bankruptcy proceedings, rather than only dischargeable in cases of "undue hardship." Even though we agree that it is advisable to review the changes made in 2005, we believe it is appropriate to keep the history of the provision in mind while doing so.

In reading H.R. 5043, CBA readily acknowledges it is a well-intentioned attempt to help former students who are having financial difficulty. There is no question that some students borrow increasingly larger amounts for higher education and therefore have trouble repaying their loans. But this legislation would do nothing about increased borrowing, nor about the reason students borrow too much: the ever escalating cost of higher education. In fact, this legislation would <u>increase</u> the cost of higher education, not help with this underlying problem Therefore, we respectfully suggest the legislation be reconsidered and modified.

[1] The Consumer Bankers Association ("CBA") is the only national financial trade group focused exclusively on retail banking and personal financial services — banking services geared toward consumers and small businesses. As the recognized voice on retail banking issues, CBA provides leadership, education, research, and federal representation on retail banking issues. CBA members include most of the nation's largest bank holding companies as well as regional and super-community banks that collectively hold two-thirds of the industry's total assets.

The cost of higher education has risen consistently for the past 20 years. Taxpayer-supported federal loan and grant programs for undergraduates have not been able to keep up. Lenders stepped in during the late 1990s to meet the needs of students and families to finance college beyond what the federal loan and grant programs are able to provide.

Millions of American families are, right now, facing the dilemma of trying to figure out how to finance college. For much of the middle class, meaning families making over about $50,000 per year, federal Pell Grants are not available. Federal Stafford student loans, which are limited to $5,500 for the first year up to $7,500 for later years for dependent students, leave a large gap for families that are not able to write checks for a cost of attendance of $25,000 or more at a public university or more than $50,000 at a private institution. PLUS loans are available to parents, but for many, private loans may be a better option. For independent students, private loans may be the only option. In addition, some parents are not able or willing to borrow using PLUS loans. These decisions are, as they should be, a decision made by the student and his or her family.

Today, private lenders are required to inform borrowers about their potential eligibility for federal aid and provide a long, detailed list of disclosures about the terms and conditions of the available loans at three separate points during the loan origination process. Borrowers also are provided detailed information by their school on their cost of attendance and other aid, institutional or federal, which they receive before they borrow a private education loan. Included in the disclosures is the fact that education loans are not dischargeable in bankruptcy proceedings except in cases of undue hardship. Finally, recent regulatory changes provide student loan borrowers the right to accept the approved loan offer for a 30-day period (during which the loan offer generally may not change), and after accepting a loan borrowers have a three-day period to rescind their loan acceptance before it is final. All of these consumer protections serve to fully inform student loan borrowers of their gap financing need and the true cost of credit and the before they borrow.

Private loans are a key part of the financial options students and their families need to have available to pay for college. Making them less available and more costly would seem to move in the opposite direction of the often-stated national goal of expanding access to higher education and increasing the percentage of the American population obtaining higher education.

The credit crisis that began in 2008 has already hurt the availability of private student loans. With capital for making loans more expensive and harder to raise, lenders have tightened their credit standards significantly. While this may reduce the risk of default overall, it also means that some prospective students who actually would benefit from higher education and would be able to repay their debt are not eligible for credit.

If this legislation passes, lenders will face increased losses from loan defaults and will, in turn, be forced to adjust the price to reflect the risk. This will result in higher fees, higher interest rates and even tighter credit screening – the opposite of what is needed to expand access to affordable higher education. Lenders won't want to take these steps but they will have to. The private loan marketplace remains competitive, and with more capital available as the credit markets improve, it should become more so. In the end, consumers who pay their loans will have to pay more to subsidize those who default and file bankruptcy. This is an outcome that is not fair, an outcome that punishes people who pay their debts.

Under current law, Congress intended to account for situations where borrowers are in financial trouble by providing for discharge in cases of undue hardship. CBA supports this option as good public policy. We understand there have been concerns raised about inconsistent application in the courts of the undue hardship standard as it exists today. But rather than simply discarding the entire provision, Congress could clarify its intent in creating the undue hardship discharge possibility.

We have additional specific issues with this legislation:

First, the legislation would apply retroactively. That means loans made in good faith by lenders since 2005 would suddenly be significantly more risky than when they were originally made. Such a retroactive change in the terms of loans previously made would set a terrible precedent, one that would have repercussions in a number of other areas and in general make the financial system less reliable. This will further increase pressure on lenders to raise prices for future borrowers, another inter-generational transfer of wealth.

Second, and equally significant, the legislation fails to consider the unusual circumstances involved in a private student loan which distinguish student loans from other types of consumer loans. Lenders decide whether to make a private loan based on a borrower's expected future ability to repay, with repayment most often commencing four or more years after the loan is made. Future potential earnings enhanced by the education are one of the key factors upon which lenders believe their loans will be repaid.

However, most people when they first leave school have no or almost no assets and have no income. Usually, this changes as borrowers find a job and start to move their life forward financially. However, many graduates, such as lawyers and doctors from high-cost institutions, might find it to be to their financial benefit to declare bankruptcy about the time they are ready to graduate and discharge their student loans. This problem was a major reason Congress chose to make student loans, both federal and private, non-discharageable in the first place.

Unfortunately debt levels have risen since the legislation passed, making that strategy of gaming the system even more lucrative. Once again, the result will be higher costs and constrained access to higher education. That is not sound public policy. We urge the Subcommittee to consider alternatives that would prevent this kind of abuse of the bankruptcy process from taking place.

Third, and illogically from the perspective of consumers, the legislation would exempt non-profit lenders – and governments – from the dischargeability rules. A borrower who is having financial problems does not care whether their loan was made by a bank or by a

non-profit student loan company - - the consumer need is identical. Singling out banks and other for-profit lenders for harsh treatment while exempting non-profits and state government lenders will provide inconsistent relief to consumers. Having different rules apply to the non-profit and for-profit lenders will simply make the market less competitive and raise the price and reduce the availability of private loans.

Finally, the legislation leaves out the largest student loan lender of all: the federal government. It seems absurd to focus attention only on one segment of the student loan marketplace, a segment that in the upcoming academic year will probably account for a little more than 10 percent of lending, while ignoring the other 90 percent.

We urge the Subcommittee to modify the legislation to make it worthy of its title by working towards a compromise that does not retroactively change the terms of outstanding loans, recognizes and accounts for the uniqueness of student loans, and applies equally to all.

Mr. JOHNSON. 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 promptly to be made a part of the record.

Without objection, the record will remain open for 5 legislative days for the submission of any other additional materials. And, again, I want to thank everyone for their time and patience. This hearing of the Subcommittee on Commercial and Administrative Law is adjourned.

[Whereupon, at 11:02 a.m., the Subcommittee was adjourned.]

APPENDIX

MATERIAL SUBMITTED FOR THE HEARING RECORD

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

Congressman Henry C. "Hank" Johnson, Jr. Statement for the Hearing on H.R. 5043, the Private Student Loan Bankruptcy Fairness Act of 2010 April 22, 2010

Thank you, Mr. Chairman, for holding this very important hearing on the Private Student Loan Bankruptcy Fairness Act of 2010.

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.

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 people who agreed to the dense and confusing terms of a private loan agreement in order to get an education to become productive citizens and contribute to our society.

And unlike federal loans, private student loan borrowers are often unable to work out terms that ensure a reasonable and fair repayment schedule.

Federal loans contain mechanisms to ensure repayment without excessive financial distress on the part of the borrower. Private student loans lack access to the important deferment, income-based repayment, or loan forgiveness options that come with federal student loans.

This leaves most private student loan borrowers at the mercy of the lender if they face financial distress due to unemployment, disability, or illness.

In short, private student loans must be addressed as we have a responsibility to ensure that our youth can obtain a quality education without going broke.

Thank you, Mr. Chairman, for scheduling this hearing. I look forward to hearing from our witnesses today.

RESPONSE TO POST-HEARING QUESTIONS FROM DEANNE LOONIN,
NATIONAL CONSUMER LAW CENTER, BOSTON, MA

Questions for the Record
Subcommittee on Commercial and Administrative Law
Hearing on H.R. 5043, the "Private Student Loan Bankruptcy Fairness Act of 2010"
April 22, 2010

Deanne Loonin, National Consumer Law Center

Questions from the Honorable Steve Cohen, Chairman

1. **What is your view of a 5-year waiting period before private student loan debt can be dischargeable?**
We believe that private student loan debts should be treated the same as other unsecured debts. Since there is no waiting period for these other debts, we do not favor a waiting period for private student loans.

2. **Mr. Hupalo testified that different types of student loan debt should be treated in an equitable manner. Should loans made by nonprofit institutions also be made dischargeable in bankruptcy?**
Yes.

RESPONSE TO POST-HEARING QUESTIONS FROM JOHN A. HUPALO,
RAMIREZ CAPITAL ADVISORS, WESTON, MA

Questions for the Record
Subcommittee on Commercial and Administrative Law
Hearing on H.R. 5043, the "Private Student Loan Bankruptcy Fairness Act of 2010"
April 22, 2010

John Hupalo, Ramirez Capital Advisors

Questions from the Honorable Steve Cohen, Chairman

1. **You testified that different types of student loan debt should be treated in the same manner. Should loans made by nonprofit institutions be made dischargeable in bankruptcy, like Senator Durbin's bill would do?**

Mr. Chairman:

Thank you again for the opportunity to testify before the Subcommittee.

As I mentioned in my written and verbal statements, I believe that all private student loans should be non-dischargeable in bankruptcy. I do not support legislation that would make loans originated by nonprofit institutions dischargeable in bankruptcy. It makes sense to me to maintain the 2005 legislation's goal of identical treatment of non-dischargeability for private student loans – regardless of the corporate structure of the lender.

There are many different types of lenders in the private student loan marketplace, including banks, finance companies, credit unions, community banks, nonprofit institutions and governmental entities. My concern is that creating classes of lenders based on the eligibility of their private student loans for discharge in bankruptcy is inequitable and will lead to market place confusion. Students already face a dizzying array of choices when selecting a loan product – adding the consideration of different bankruptcy options will only further confuse students. Futhermore, with the loss of discharge protection, nonprofit institutions will need to raise the price of their loan products for all borrowers to compensate for the potential of substantial increase of loss due to loans successfully discharged in bankruptcy.

LETTER TO THE HONORABLE STEVE COHEN, CHAIRMAN, SUBCOMMITTEE ON COMMERCIAL AND ADMINISTRATIVE LAW, FROM THE NATIONAL CONSUMER LAW CENTER AND THE NATIONAL ASSOCIATION OF CONSUMER BANKRUPTCY ATTORNEYS

April 15, 2010

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 National Consumer Law Center's low-income clients and the National Association of Consumer Bankruptcy Attorneys, we are writing to express our strong support for the *Private Student Loan Bankruptcy Fairness Act of 2010*.

Private student loans are made by lenders to students and families outside of the federal student loan program. Unfortunately, many private student lenders followed the path of the subprime mortgage industry and pushed high priced, unaffordable loans on students. These loans are one of the riskiest, most expensive ways to pay for college.

Our clients at the National Consumer Law Center's Student Loan Borrower Assistance Project are low-income consumers who seek to improve their lives through education. The current law unfairly punishes these borrowers if their attempts to pursue higher education do not lead to financial rewards. Unlike most other unsecured debtors, it is nearly impossible for them to discharge oppressive student loan debt and get a fresh start.

Private student loan borrowers also lack access to the important deferment, income-based repayment, or loan forgiveness options that come with federal student loans. This leaves most private loan borrowers at the mercy of the lender if they face financial distress due to unemployment, disability, illness or military deployment, or when a school shuts down before they can finish their certificate or degree.

It is way past time to give financially distressed student borrowers equal access to bankruptcy relief. Thank you for your leadership on this important issue.

Sincerely,

National Consumer Law Center
Boston, MA

National Association of Consumer Bankruptcy Attorneys
Washington, D.C.

Coalition Letter to the Honorable Steve Cohen, Chairman, Subcommittee on Commercial and Administrative Law

April 21, 2010

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 are writing to express our strong support for the *Private Student Loan Bankruptcy Fairness Act of 2010.*

Private student loans are one of the riskiest, most expensive ways to pay for college. Like credit cards, they typically have variable interest rates that are higher for those who can least afford them. However, private student loans are treated much more harshly in bankruptcy than credit cards and other comparable types of debt.

Private student loan borrowers also lack access to the important deferment, income-based repayment, or loan forgiveness options that come with federal student loans. This leaves most private loan borrowers at the mercy of the lender if they face financial distress due to unemployment, disability, illness or military deployment, or when a school shuts down before they can finish their certificate or degree.

The *Private Student Loan Bankruptcy Fairness Act of 2010* would reverse the unfair and unjustified special bankruptcy protections for private student lenders included in the 2005 bankruptcy law. Our broad coalition of groups representing students, consumers, and institutions of higher education, and civil rights and public policy organizations thanks you for your leadership on this important issue.

Signed,
American Association of Collegiate Registrars and Admissions Officers
American Association of Community Colleges
American Association of State Colleges and Universities
American Association of University Women
American Council on Education
American Federation of Teachers
Americans for Financial Reform*
Campus Progress Action
Consumer Action
Consumer Federation of America
Consumer Watchdog
Consumers Union
Dēmos: A Network for Ideas & Action
Empire Justice Center
The Greenlining Institute
The Institute for College Access & Success and its Project on Student Debt
National Association for Equal Opportunity in Higher Education
National Association of College Admission Counseling
National Association of Student Financial Aid Administrators
National Center for Public Policy and Higher Education
National Consumer Law Center (on behalf of its low income clients)
National Consumers League
National Council of La Raza
Rock the Vote
U.S. Public Interest Research Group
UNCF
United States Student Association

* A large number of organizations are working together to advance Americans for Financial Reform's (AFR) common interest in an accountable, transparent and secure financial system, and to accomplish our shared policy goals. Because the organizations involved and the issues addressed are diverse, not every organization works on or has a policy position on every specific issue. We are unanimous in our call for change to repair our nation's broken financial system, establish integrity in the financial markets, and facilitate productive economic activity that benefits all segments of our communities.

PREPARED STATEMENT OF THE FINANCIAL SERVICES ROUNDTABLE

STATEMENT FOR THE RECORD

THE FINANCIAL SERVICES ROUNDTABLE

for

The House Judiciary Committee, Subcommittee on Commercial and Administrative Law
Hearing on
"H.R. 5043, the Private Student Loan Bankruptcy Fairness Act of 2010"
April 22, 2010

The Financial Services Roundtable ("Roundtable") respectfully offers this statement for the record to the United States House Judiciary Committee, Subcommittee on Commercial and Administrative Law, hearing on H.R. 5043, the Private Student Loan Bankruptcy Fairness Act of 2010.

The Financial Services Roundtable represents 100 of the largest integrated financial services companies providing banking, insurance, and investment products and services to the American consumer. Member companies participate through the Chief Executive Officer and other senior executives nominated by the CEO. Roundtable member companies provide fuel for America's economic engine, accounting directly for $74.7 trillion in managed assets, $1.1 trillion in revenue, and 2.3 million jobs.

The Roundtable Supports Student Lending:
The Financial Services Roundtable supports the public policy goal of ensuring that college or an advanced education is available to every American and believes it is critical to the future competitiveness of our nation. The Roundtable supports public policies that promote the role of private sector lenders in the student loan market. Competition among private lenders should continue to be encouraged, as it benefits students. The Roundtable respectfully urges Congress not to support policies that harm competition in the student loan marketplace, which will ultimately limit the options available to students seeking to finance their education.

Roundtable Opposses H.R. 5043:
The Financial Services Roundtable respectfully opposes H.R. 5043, the Private Student Loan Bankruptcy Fairness Act, sponsored by Representative Steve Cohen (D-TN). If enacted, the bill would change retroactively the terms of existing private education loans, making them dischargeable in bankruptcy immediately upon graduation. This overly broad change would result in greatly increasing the

cost of financing higher education. The Roundtable urges members of the Judiciary Committee to oppose this measure.

Under bankruptcy law today, student loans - both those guaranteed and made by the federal government and private education loans – cannot be discharged in bankruptcy unless a borrower demonstrates that the debt will prove an undue hardship upon their exiting bankruptcy. The bankruptcy law distinguishes student loans from other debt because these loans do not finance a physical asset that acts as security for the extension of credit. Student loans finance the intangible asset of a college education, which provides direct financial earning power that continues and grows for a lifetime.

This legislation would retroactively re-write the rules governing private loan contracts, and does not require borrowers to make even some kind of repayment before their loan can be discharged. This lack of reasonable protection would encourage the very abuses of the bankruptcy code that Congress acted to prevent years ago. The special carve out for non-profit lenders will create an unlevel playing field between the private and public student loan industry by denying millions of consumers the same bankruptcy options. Furthermore, there is no public policy argument for extending protections to borrowers based on the tax-status of their lender. Any changes to bankruptcy law should be prospective, should include reasonable protections against abuses, and should apply to all borrowers - including those served by government.

Conclusion:

If student loan borrowers can just walk away from their student loan debt after graduation, it will severely restrict access to those with need, increase interest rates for all students, and significantly increase the moral hazard in private student lending. We respectfully urge the Committee to oppose H.R. 5043.

○