Hearing on "The Looming Student Debt Crisis: Providing Fairness for Struggling Students
Questions for the Record
Senator Dick Durbin

Questions for Deanne Loonin

1. As you know, under current law student loans can be discharged in bankruptcy if the debtor can establish "undue hardship." This term has been interpreted by the courts very restrictively and few bankruptcy debtors can afford to litigate the issue before the bankruptcy court and on appeal.

   a. In your experience, does the "undue hardship" exception provide most student debtors with a realistic path for relief from loans they cannot afford to repay?
   b. Do you see any problems with the case-by-case analysis approach under the current "undue hardship" system?

   Response from Deanne Loonin

   1.a. In my experience representing low-income borrowers, consulting with other lawyers across the country, and analyzing case law, I have found that the "undue hardship" exception system is random, arbitrary and unfair. Few borrowers obtain relief from student loan debt through this system.

   1.b. The case by case analysis sets a very high procedural bar for debtors. They must file a separate adversary proceeding in bankruptcy court and be prepared to litigate. Most financially distressed borrowers do not have the knowledge or resources to follow through or even start this difficult and expensive process.

   Bankruptcy courts consider a debtor's individual financial circumstances through the means test and other "point of entry" requirements. The undue hardship system is an unnecessary and unfair additional test applied only to student loan debtors. It conflicts with the primary purpose of bankruptcy, which is to give a fresh start to financially distressed debtors.

2. In your experience, have private student lenders been willing to work with struggling borrowers to craft reasonable repayment plans? Would making private student loans dischargeable again increase the incentive for lenders to negotiate with distressed borrowers before calling in the collection agency?

   Response from Deanne Loonin

   In NCLC's experience representing borrowers through the Student Loan Borrower Assistance Project, we have found private lenders to be inflexible in granting relief for borrowers. We also find that many private student loan collectors use the lack of bankruptcy alternatives as a way to place unrealistic and in some cases improper or illegal pressure on borrowers. It seems likely that taking away this bankruptcy break for

lenders would encourage them to offer a wider range of options for financially distressed borrowers.

3. Typically whenever bankruptcy reforms are proposed that would assist debtors, creditors claim that such reform will hurt consumers by raising the cost and reducing the availability of credit. Back before private students loans were made nondischargeable in 2005, was there a healthy private student loan market?

Response from Deanne Loonin

The private student loan industry grew rapidly during the pre-2005 period when these loans were fully dischargeable in bankruptcy. The private student loan industry has contracted in recent years even with a restrictive bankruptcy policy. The more restrictive credit market has helped eliminate loans that never should have been made. There is simply no evidence that changes in the market, positive or negative, are caused by changes in bankruptcy policy.

4. During the hearing I described as a mystery amendment the provision in the 2005 bankruptcy reform law making private student loans nondischargeable. I have since been informed, and I want to clarify for the record, that this provision was originally authored by then-Representative Lindsey Graham in 1999 who offered this language as a modification to an amendment on the House Floor, and that it was subsequently included in the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005. However, it is still my understanding that this provision was not the subject of significant Congressional discussion or analysis between 2000 and 2005. Are you aware of any such discussion or analysis?

Response from Deanne Loonin

The National Association of Consumer Bankruptcy Attorneys (NACBA) analyzed this issue after the March 20 hearing. After conducting a review of the bills introduced in the 105th, 106th, 107th, 108th, and 109th Congresses, as well as hearing records, committee reports, floor debate and advocacy materials, NACBA found one piece of testimony and three minutes of floor debate on this issue. This is an insignificant amount of time given that the debates over changes to the bankruptcy code spanned eight years and five congresses, nearly 20 hearings, and countless days of debate. A copy of NACBA's analysis is attached.

5. Do you have suggestions of ways that relief can be provided outside of bankruptcy to overwhelmed student loan borrowers:
   a. For federal loans?

   b. For private loans?

Response from Deanne Loonin

5.a. Federal Loans

At a minimum, Congress and the Department of Education should strengthen the existing Higher Education Act cancellation/discharge programs, particularly those intended to provide relief to borrowers harmed by abusive school practices. Relief may be extended in some cases through regulatory action. In other cases, Congressional action is necessary.

Among other changes, we urge broadening relief available through the false certification discharge to all cases where the school falsifies the requirements for loan eligibility or otherwise improperly certifies loan eligibility. In addition, the false certification/identity theft cancellation adopted in 2006 remains mostly an illusory right as long as borrowers are required to prove that a crime was committed in order to obtain relief.

Providing much-needed relief for vulnerable borrowers will not necessarily require significant government funding as long as the Department of Education is encouraged to use its existing authority to pursue reimbursement from schools. We do not believe the Department is currently using this authority to seek reimbursement from schools AFTER granting discharges to qualified borrowers. We describe additional proposals to expand relief for financially distressed borrowers in comments submitted to the Department of Education in May 2011.[1]

5 b. Private Loans

The right to assert defenses to repayment of the loan and bring school-related claims against lenders is especially important when private lenders have close ties to for-profit schools that promote, package or help the lender market their private loan products. In these cases, borrowers are often limited in the relief directly available from schools, many of which are out of business or insolvent by the time borrowers seek redress. Even borrowers who successfully obtain damages from an unscrupulous school are often left with significant loan debt.

A key to lender liability in many cases is the FTC holder rule. The holder rule puts lenders on the hook when they have "referring relationships" with schools that defraud students or shut down unexpectedly.[2] The holder rule gives lenders an incentive to scrutinize the schools with which they have close relationships and to originate loans only with upstanding schools.

Because the FTC does not have jurisdiction over banks, the holder rule only applies to schools, not depository lenders. That is the FTC rule obligates only the schools, not the lenders, to include the holder notice in the contract. In general, the school must insert the notice in consumer credit agreements, whenever the school is the originating lender and must arrange for the lender to insert the notice in the lender's credit agreement whenever the school refers the consumer to the lender or otherwise has a business arrangement with the lender. The remedy is to require all lenders that have close relationships with a school to include the holder rule in the loan contracts and to prohibit measures to undercut the rule.

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[1] The comments are available in this section of our web site: http://www.studentloanborrowerassistance.org/legal-policy/.

[2] 16 C.F.R. §433.2.

Other key reforms include:

- Encourage and, where appropriate, require loan modification standards for distressed borrowers and discharges in case of death or disability.
- Extend Fair Credit Billing Act rights to private student loan borrowers.

Attachment

NACBA Memo

National Association of Consumer Bankruptcy Attorneys

Via e-mail

April 9, 2012

TO: Deanne Loonin, National Consumer Law Center

FROM: Maureen Thompson, Legislative Adviser,
National Association of Consumer Bankruptcy Attorneys

RE: Clarification of legislative history of private student loan discharge in bankruptcy

In the February 2012 report of the National Association of Consumer Bankruptcy Attorneys (NACBA), *"The Student Loan 'Debt Bomb': America's Next Mortgage-Style Economic Crisis,"* it was asserted that "an unidentified lawmaker" slipped a provision into the 2005 Bankruptcy Abuse Prevention and Consumer Protection Act that made private student loans non-dischargeable in bankruptcy. It further was asserted that there were "no hearings or public discussion of such a fundamental change in policy on private student loans during the several years the bankruptcy bill was under discussion."

Those statements, while believed to be true by those from the consumer community who were most actively involved in the nearly eight year debate leading up to the 2005 Bankruptcy Act, are not entirely accurate.[1] After conducting a review of the bills introduced in the 105th, 106th, 107th, 108th and 109th Congresses, as well as hearing records, committee reports, floor debate and advocacy materials, this memo is intended to correct the record with respect to the origin of the private student loan provision in the 2005 Act.

As you know, a version of what became the 2005 Bankruptcy Act was first introduced in the 105th Congress in 1998 (H.R. 3150 and S. 1301). There was no provision related to private student loans in the first bills as introduced. Over the course of 1997 and 1998, the Senate Judiciary Subcommittee on Administrative Oversight and the Courts held three hearings on consumer bankruptcy issues and heard from 25 witnesses. No witness raised the private student loan discharge issue. During the Subcommittee mark up, eight amendments were considered. None dealt with the private student loan issue. When the full Judiciary Committee considered the bill, 13 amendments were offered. None dealt with the private student loan issue.

[1] Indeed, Stephen Burd, who covered this issue for the Chronicle of Higher Education, said in an April 2007 interview with Robert Siegel on NPR's "All Things Considered" program: "The interesting thing I'd point out about the private loan part of this is that although the bankruptcy bill was before Congress for almost a decade, I believe, there was very little to no discussion about this provision. In fact, there were no hearings on this. It didn't get a lot of attention because private loans as opposed to federal loans used to really only go to graduate and professional students." ("2005 Law Made Student Loans More Lucrative, April 24, 2007). Likewise, Ranking Member of the Judiciary Committee, Rep. John Conyers, said in a September 23, 2009 hearing: "As I recall, this particular amendment was never the subject of any formal Congressional hearing."

During that same time period (1997 and 1998), the House Judiciary Committee and its Subcommittee on Administrative and Commercial Law held seven hearings on the operation of the bankruptcy system, including four hearings devoted to the legislation, H.R. 3150. More than 60 witnesses offered testimony at the hearings. Just one witness, Jill Sturtevant with the American Bankers Association, raised the issue of dischargeability of private student loans in bankruptcy. In her testimony, Ms. Sturtevant recommended "technical" amendments to the proposed legislation, one of which was that private student loans be made non-dischargeable in bankruptcy. Ms. Sturtevant devoted four short paragraphs of her testimony to this recommendation.

During the Judiciary Committee mark up of the legislation, a dozen amendments were considered; none dealt with private student loans. The issue was not raised during floor debate nor was it raised during the House-Senate Conference Committee.

Legislation to overhaul the bankruptcy system was introduced again in the 106th Congress. The private student loan provision was not in the bills as introduced, nor was the provision added during Committee deliberation. Instead, then-Representative Lindsey Graham on May 5, 1999, offered an amendment during the House floor debate on H.R. 833 to extend the non-dischargeability of student loans to private loans. A total of three minutes of floor time was devoted to the debate. After Rep. Graham agreed to narrow the scope of the amendment, it was agreed to by a voice vote. The provision was in every subsequent bankruptcy bill.

This one piece of testimony and three minutes on the floor in 1999 appears to be the sum total of congressional debate on the issue of the treatment of private student loans in bankruptcy. The debate over changes to the bankruptcy code spanned eight years and five congresses, and included 18 hearings in the House Judiciary Committee and six hearings before the Senate Judiciary Committee and countless days of floor debate in both chambers.

Given this history, it is a fair characterization to say the provision was "slipped into the bill," though it is not technically correct. We stand corrected on not knowing the identity of the lawmakers who sponsored the provision. A closer inspection of the record identifies then Rep. Lindsey Graham as the sponsor.