

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

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

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

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

Two studies released in August raised concerns for the Members of CBC Community Reinvestment Taskforce with regard to the bankruptcy protections afforded to private educational debt. In late August, a study by the Project on Student Debt indicated a dramatic increase in the use of private student loans by undergraduates today than four years ago. The study showed that the percentage of undergraduates relying on private educational debt almost tripled from 5% in 2003-2004 to 14% in 2007-2008. Further, in 2007-2008, approximately two-thirds (64%) of the students with private loans under-borrowed federal loans, up from 48% in 2003-2004. Although students from all races and ethnicities were equally likely to turn to private loans before exhausting their federal loans in 2007-2008 and although all racial and ethnic groups increased their borrowing of private educational debt, African American students

were statistically more likely than other students to borrow private student loans in 2007-2008, with the percentage quadrupling from 4% to 17% in the last four years. It is of great concern that tens of thousands of students, and especially African American students, are relying on loans that, in addition to a dearth of basic consumer protections, receive statutory protection from bankruptcy except under extreme circumstances.

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

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

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

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

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