

STATEMENT OF

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on behalf of the

NATIONAL ASSOCIATION OF CONSUMER BANKRUPTCY ATTORNEYS

before the

SUBCOMMITTEE ON COMMERCIAL 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.<sup>1</sup> 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.<sup>2</sup>

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<sup>1</sup> 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>

<sup>2</sup> 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 based 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.”<sup>3</sup>

Private student loans typically have variable interest rates that are higher for those who can least afford them. In 2008, interest rates for private loans were as high as 18 percent, based in part on the borrower’s credit score. These variable rates are rarely capped and can change as often as once a month. Fees vary widely between lenders and even between borrowers with the same lender. Promissory notes usually give the loan holder broad authority to increase borrower costs, such as raising interest rates in response to late payments.<sup>4</sup>

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,”<sup>5</sup> 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[.]”<sup>6</sup> 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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<sup>3</sup> Asher.

<sup>4</sup> Asher.

<sup>5</sup> The report is online at [www.studentloanborrowerassistance.org/uploads/File/TooSmalltoHelp.pdf](http://www.studentloanborrowerassistance.org/uploads/File/TooSmalltoHelp.pdf)

<sup>6</sup> NCLC Student Loan Borrower Assistance webpage on “Default and Delinquency.” Online at [www.studentloanborrowerassistance.org/default-and-delinquency/#private](http://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.<sup>7</sup> 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.

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<sup>7</sup> 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.