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Student Loans: Bankruptcy May Not Have the Answers— But Does Congress?

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NUMBERS, DRIVERS, AND PROFILES OF STUDENT LOAN DEBT

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Thirty-seven million Americans--some 19.9% of American households—owe student loans. The average debt load for a four-year college graduate in the class of 2010 was more than $25,250. Students in graduate school borrow much more, and averaging over $43,500, and individual loan debt exceeding $150,000 is not uncommon. Many middle-aged and senior citizens also have student loan debt, in addition to parents and relatives who have co-signed student loans. As of 2012, less than 40% of student loan debt was in repayment status according to the original terms, and a recent study finds that approximately 21% of current student loans are delinquent or in default. This article will examine the numbers and drivers of student loan debt, overview the student loan industry, and provide personal profiles of student loan debts.

I. Spiraling Education Cost, Spiraling Education Borrowing

Since 1990, the cost of education has mushroomed far in excess of the cost of living. In 1990-91, the cost of tuition, room, and board at an average four-year public college was $8,403, and $21,218 for a private four-year college. As of 2000-01, this increased to $10,609 for a public college, and $26,795 for a private one. By 2011-12, these numbers were $17,131 and $38,589, respectively. For another perspective, in January 2000 the cost of education and the consumer price index were both at 100. As of July 2012, CPI stood at 135, while the cost of education had increased to 196. The cost of a college education has risen by three times the cost of inflation since 1983. Overall, the cost of higher education in America is among the highest in the world.

As education costs have spiraled, education borrowing has also spiraled. In 2000-01, total education loan debt stood at $43,453,000. As of the first-quarter 2012, federal student loan debt was approximately $904 billion with private loans adding another $150 billion, surpassing both consumer credit card debt ($679 billion) and auto loan debt ($737 billion). Students borrowed $103.9 billion in 2010-11 alone. As of 2011, borrowing for education at non-profit schools averaged 42% of the cost of an education, while the borrowing rate at 2-year for-profit schools may be as high as 98%. The Department of Education expects new federally guaranteed student loans in 2013 to total $154.4 billion. Yet the fastest growth is for students at for-profit schools, even though students at these schools have a lower graduation rate, higher debt, and higher tendency to default on loans.

In 1989-1900, students graduating from public four-year colleges averaged $8,200 in debt, while average debt at private colleges was $10,600. In 1999-2000 the amounts increased to $15,100 and $16,500, respectively. But over the decade 2000-02 through 2010-11, federal loans per full-time undergraduate student shot up at an average rate of 5% a year after adjusting for inflation, for a total increase of 57% for the decade. As of 2010, 54% of students at public four-year colleges had borrowed for education, with an average debt of $22,000. Of students earning bachelor's degrees at private non-profit institutions, about 66% had borrowed for their education, and the typical debt load was $28,100. Averaging all four-year non-profit schools, the mean debt per student in 2010 was $25,250. A typical undergraduate student received $4,907 in federal loans in 2010-11, while the average graduate student received $16,423 in federal loans during the same period. For graduates obtaining professional degrees, the borrowing rate was much higher, with some 79% having obtained loans for school as of 2007-2008. The plight of law school graduates, with an average debt load of $98,500 at graduation in 2010, has been well-noted in the press. And none of these numbers include private loans, which are more difficult to track.

It is not just younger people who go into debt for education. In recent years, education borrowing by people ages 35 to 49 has also grown rapidly. In addition, parents are incurring debt to cover college costs for their children. In 1992-93, 5.6% of parents took out loans for their children's education. By 2010, that number had risen to 17%. Loans to parents for their children's college education account for approximately $100 billion, or about 10% of the estimated $1 trillion in education debt. And many older people remain saddled with debt from their own college years. One study finds that people aged 60 and older hold $36 billion in student loan debt, of which some 10% is delinquent.

Borrowing rates are different for-profit programs than at public and private institutions. For example, as of 2009, only 15% students who started post-secondary studies at a four-year for-profit institution had earned a degree. And of those graduates, two-thirds had debt over $28,000. In contrast, for dependent students who started at a public four-year institution, 64% had earned a bachelor's degree, but only 14% of them borrowed more than $28,000. In 2008, proprietary students studying for an associate's degree had median federal debt of approximately $14,045, compared to median debt level of $7,125 for students at private, not-for-profit schools. Similarly, students seeking a bachelor's degree at proprietary four-year schools had median debt of $23,874, more than double the debt level of $11,580 for students at private non-profit schools, and five times the debt of $4,968 for students at public schools.

Student loan debt is clearly concentrated in young adults. Of people under the age of thirty, 40.1% have student loan debt, while among people between the ages of thirty and thirty-nine, 25.1% have student loan debt. In contrast, only 7.4% of people over forty have student loan debt. Overall, $580 billion of the $870 billion federal student loan balance is owed by people under the age of forty.

II. The Student Loan Industry

The student loan industry is a massive, profit-making enterprise. With loan assets of $1 trillion, and lending in 2013 exceeding $150 billion, the student loan business eclipses almost any private industry in annual sales.

A. *Federal Loan Programs*

Federal funding for student loans began as a response to the Cold War and the launch of the Soviet Sputnik satellite in 1957. Subsequent expansion included grants and loans to assist medical and health program students, the Guaranteed Student Loan Program (1965), Higher

Education Amendments Act (1972) to provide grants and loans for junior colleges, trade schools, and career colleges, the Middle Assistance Act (1978) offering education grants and loans to middle-class families, and the Parent Loans for Undergraduate Students Program (1981) which allowed families of all income levels to obtain loans for dependent students, albeit at higher interest rates. The GSL program was revised in 1988 to become the Federal Stafford Loan Program. Its primary purpose was to provide low-cost loans guaranteed by the U.S. government. In 2007, the College Cost Reduction and Access Act increased Pell grant amount, reduced interest rates on subsidized student loans, and capped loan repayment at 15% of discretionary income. One of the basic policies of federal education grant and loan programs is to make college accessible regardless of economic background.

Through 1993, private banks made student loans under the Stafford program, and the Department of Education would subsidize loans and reimburse banks if borrowers defaulted. The Stafford program was modified in 1993 with the creation of the Federal Family Education Loan Program (FFELP) and the William D. Ford Federal Direct Loan program. FFELP continued the policy of students obtaining federally guaranteed loans through banks. However under the Ford loan program, students borrowed funds directly from participating schools, which received funds from the Department of Education. From 1993 to 2010, applicants for a Stafford loan could get their loans through either the Ford program or FFELP. Approximately 80% of all federal student loans were made through FFELP. Lenders under FFELP made loans without regard to the student's creditworthiness. The federal government guaranteed the loan against default. Today, federal loans constitute about 75% of all education loans, and 93% of all new loans made in 2010-2011.

To entice private lenders to make loans to students, FFELP lenders were promised a guaranteed rate of return called the "special allowance rate." The special allowance rate was based upon an average of 3-month commercial paper rates, plus certain factors for loans in repayment or in deferment or grace. This was in addition to the federal loan guarantee if the borrower defaulted.

A major restructuring of student loans took place in 2010 with the enactment of the Health Care and Education Reconciliation Act. That act contains the Student Aid and Fiscal Responsibility Act ("SAFRA"). A key provision of SAFRA is to remove private banks as middlemen in the student loan process, which is intended to save the cost of subsidizes and guarantees paid to banks, and then redirect that savings to need-based grants. Loans are now made directly to students through the U.S. Department of Education, ending the FFELP program. For loans made before 2010, lenders receive the higher of the special allowance rate or the student interest rate set by the government for new student loans. If the student rate is lower than the special allowance rate, the government makes up the difference. In the event that the student rate is higher, the lender pays the difference to the government.

Currently, the federal government originates four types of loans: Subsidized Stafford, Unsubsidized Stafford, PLUS and Consolidation loans. The Subsidized Stafford loan offers the lowest interest rate, presently at 3.4%. Borrowers must meet a financial needs test based on family income, and after July 1, 2012 graduate and professional students were no longer eligible for these loans. The three other types of loans are available to borrowers at any income level.

Previously, the government paid the interest on the loan during the time the student was in college, as well as a six-month grace period following graduation, and for any deferment periods. However, as of July 1, 2012 students are charged interest immediately following graduation.

Unsubsidized Stafford loans are made without regard to financial need. The interest rate was fixed at 6.8% for loans made after July 1, 2006, and the government does not pay any of the interest. Students can defer payment of interest while in school, but accrued interest will be capitalized at the start of repayment. PLUS Loans (Parents Plus) are available to parents with dependant undergraduate, graduate, and professional degree students. Interest is 7.9% and accrues immediately upon disbursement of the loan. Plus Loan applicants may not have any adverse credit history. Consolidation Loans are available for borrowers with existing loans in order to combine the loans and extend payment schedules and terms based on their total existing loans. The interest on a Consolidation Loan is based upon the weighted average of all loans being consolidated, rounded up to the nearest 1/8 of 1%.

Subsidized and Unsubsidized Stafford Loan amounts are capped as follows:

	Annual Limits	Annual Limits
Dependant Undergraduates	**Stafford**	**Total (Stafford & Unsubsidized Stafford)**
First-Year Student	$3,500	$5,500
Second-Year Student	$4,500	$6,500
Third-Year Student	$5,500	$7,500
Independent Undergraduates		
First-Year Student	$3,500	$9,500
Second-Year Student	$4,500	$10,500
Third-Year Student	$5,500	$12,500
Graduate Students	$8,500	$20,500
	Aggregate Limits	Aggregate Limits
Dependant Undergraduates	$23,000	$31,000
Independent Undergraduates	$23,000	$57,500
Graduate Students	$65,500	$138,500

Education lending is an income-producing endeavor for the federal government. Profit is made on the spread between the government's borrowing rate, presently around 1%, and the subsidized lending rate, currently at 3.4% for the lowest rate Subsidized Stafford loan and increasing with other types of loans. This is in addition to the origination fee of 1%. The Department of Education anticipates that federal subsidized student loan activity (including new loans and consolidation of existing loans) will generate $38.9 billion in revenue for the government in 2012, and approximately $36.8 billion in 2013. The federal government expects to earn 20.08% on each dollar of loans originated in 2013.

B. *Non-federal Student Loans*

In addition to federal education loans, private lenders also loan money to students. About 2.9 million students currently have private loans. Private loans peaked at $22 billion in 2007-2008, but dropped to $6 billion by 2010-2011 due to increased caps on federal loans and tighter lending standards. Currently, private loans constitute approximately 14% of total student borrowing. The total of private loans is $150 billion.

A student might take out a non-federal loan if he has reached the annual or aggregate federal loan cap. Unlike federal loans, most of these are priced according to credit-worthiness standards, and there is no cap on interest rates. Interest rates on private loans are usually much higher than federal loans, with some as high as 15% or more. Many private loans include adjustable interest rates without caps that can be adjusted without notice. There are no loan limits, but there also no deferments, income-contingent repayment, or any of the other relief available in federal loan programs. Private loans are considered riskier than federally guaranteed loans, yet more than half of student borrowers fail to max out government loans before incurring private loans. Overall, student lending is a highly profitable business.

The largest private lender is Student Loan Marketing Association (Sallie Mae). Established in 1972, Sallie Mae is financed by borrowing money, then relending to students at a higher rate. Student Loan Asset Backed Securities ("SLABS") were invented by Sallie Mae in the early 1990s. These are securitized portfolios of student loans, similar to Fannie Mae securities backed by home mortgages. The assets behind the securities are the loans themselves. In 1990 there were $75.6 million Sallie Mae securities in circulation, in 2010 annual trading was $250 billion. Up to 30% of student debt is securitized.

Private lenders have been accused of offering schools incentives such as paid trips for financial aid officials and guests to conferences in vacation spots, gifts awarded through raffles, "set-asides" (loans for international students and those with poor credit), and even cash payments directly to schools in order to encourage schools to steer students to a lender's loan programs. Reform measures subsequently curbed some, but not all of these abuses.

C. *Student loans and higher education costs: cause, effect, and cause again*

Some commentators assert that the broad availability of education credit has itself fueled the increase in education costs. Known as the "Bennett Hypothesis," it postulates that increases in education credit creates more students with funds to go to college, so schools raise tuition in order to capture the increase in federal money. It was first articulated by William Bennett, Education Secretary under Ronald Reagan, who wrote in a 1987 op-ed piece, "[i]ncreases in financial aid in recent years have enabled colleges and universities to raise their tuitions, confident that the Federal Government loan subsidies would help cushion the increase." As colleges charge more, school loan credits must increase in order to keep pace with education costs, and the cycle repeats. Higher tuition and loans to pay them have spurred building booms at university across the U.S., and allowed programs that utilize federal loan funds to charge far more than programs that do not. Proponents of the Bennett Hypothesis assert that the upward trend in education costs will not be contained as long as low-cost student loans are available.

III. Student Loan Borrowers – Numbers and Profiles

A. *Student Loan Debts and Undue Hardship Discharges*

To better understand the incidence of education loan debt in bankruptcy, I obtained data from 50 consumer Chapter 7 and Chapter 13 cases filed each year in ten randomly selected jurisdictions from 2004 through 2011.[1] Of the approximately 3,750 cases that I reviewed, 814 reported student loan debt. The table below shows the percentage of cases in which the debtor(s) reported student loan debt for each year, and the average amount of student loan debt per case.

	Chapter 7		**Chapter 13**	
Year	Percent w/ student debt	Average student loan debt	Percent w/ student debt	Average student loan debt
2004	18.0	$18,484	14.6	$13,332
2005	18.9	$12,545	14.7	$23,208
2006	19.0	$16,644	22.2	$16,304
2007	23.2	$21,055	22.1	$21,699
2008	19.9	$28,213	19.1	$17,497
2009	21.8	$29,992	22.0	$26,908
2010	21.3	$21,360	24.2	$24,396
2011	24.3	$25,096	22.3	$26,483

There are some anomalous results. For example, there was a significant decline in student debt reported in Chapter 13 cases in 2006. In addition, the amount of debt per case peaked in 2009, the height of the recession. And while it eased back in 2010, by 2011 the average of student loan debt was again on the rise. Cleary, student loan debt is an increasing factor in consumer bankruptcy.

My review of bankruptcy cases also revealed that debtors overwhelmingly self-select to not discharge student loan debt in bankruptcy. Of the 814 cases with student loan debt, only two Chapter 7 debtors and one 13 Chapter debtor filed adversary proceedings to have their student loans discharged. In a 2009 Chapter 7 case, the debtor obtained a discharge of $79,000 in student loans by establishing undue hardship as a result of severe injuries received in a car accident. The debtor in a 2011 Chapter 7 case withdrew her adversary proceeding to discharge $15,000 in private student loan debt upon after a settlement with the creditor to pay most of her debt. In the Chapter 13 case, the debtor listed a student loan claim of $47,890 on Schedule F, but asserted in his adversary proceeding that his signature on the loan was a forgery and that had

[1] The jurisdictions include Arkansas Eastern District, Arizona, California Southern District, Georgia Middle District, Indiana Southern District, New York Northern District, Oklahoma, Oregon, Pennsylvania Western District, and Wisconsin Eastern District. Electronic filing was not fully available in Georgia, Indiana, and Wisconsin in 2004, so these jurisdictions were not included for that year. This data is based on amounts reported by debtors on Schedules E (priority unsecured debt) and Schedule F (general unsecured debt). The data presents a general view of student loan debt, and does not purport to be an exact accounting of student loan debt. For example, many student loan debts were listed in round numbers (i.e., $15,000) whereas the actual amount owed was likely not such a simple number. In addition, as with many debts, debtors may have estimated the amount. Also, the data does not differentiate between debtors filing singly and those filing jointly. Finally, the data adjusts for a statistical anomaly in a 2004 Chapter 7 case.

been unaware of it until the debtor defaulted and the creditor sought to collect against him. The court ultimately entered an order that the debt not be excepted from discharge, and the debt was discharged.

Even in seemingly plausible cases the debtors did not attempt to have the debt discharged. In one case for example, married debtors had an income consisting of the husband's modest salary as a pressman which put them below the state median income. With expenses, including student loan payments of $218 per month, the debtors showed negative monthly income of $267.26 per month. They live in a home valued at $149,000 against which there are two mortgages, the second one being mostly unsecured. Yet their combined education debt is $71,000, with an additional $25,000 of general unsecured debt. The debtors clearly cannot afford to repay the student loan debt, yet they elected not to attempt to discharge the debt. A number of the cases I reviewed showed debtors with high five-figure or six-figure student loan debt and modest income, but they did not attempt to have the debt discharge. It seems likely that at least some of these debtors will never be able to pay their student debt, but seemingly the "undue hardship" standard is out of reach for them.

My own research and other recent students confirm that nearly half of debtors who filed an adversary proceeding for an undue hardship discharge were successful in obtaining some relief.[2] Furthermore, debtors who did obtain a student loan debt discharge were likely to have a medical problem or a dependant with a medical problem, be unemployed, and have nominal or no income in the year prior to filing bankruptcy.

B. Profiles of Individual Student Loan Debtors

There are numerous online sites where commentators and student debtors chronicle their experiences.[3] The poster-child for crushing student loan debt may be a family practitioner in Columbus, Ohio, whose $250,000 in loans for medical school eventually mushroomed to $550,000 after deferments for her residency, missed payments with late fees, and compounding interest.[4] A more typical situation is a student who borrowed $79,000 in loans to study interior

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[2] Rafael I. Pardo and Michelle R. Lacey, *Undue Hardship in the Bankruptcy Courts: An Empirical Assessment of the Discharge of Education Debt*, 74. U. of Cinn. L. Rev. 405. (Winter 2005); Jason Iuliano, *An Empirical Assessment of Student Loan Discharges and the Bankruptcy Undue Hardship Standard* (2011) Electronic copy available at: http://ssrn.com/abstracts=1894445.

[3] *See, e..g,* Janet Lorin *Indentured Students Rise As Loans Corrode College Ticket*, Bloomberg.com, July 9, 2012, *available at* http://www.bloomberg.com/news/2012-07-09/indentured-students-rise-as-loans-corrode-college-ticket.html. (accessed July 12, 2012)). The author relates how a mother in the 1960s incurred $5000 in debt for her nursing degree, which she paid off within three years after graduation, while her 38-year old son incurred $85,000 in debt for a master's degree, can't find work, and lives at home. See also, Andrew Martin and Ander W. Lehren, *Degrees of Debt: A Generation Hobbled by the Soaring Cost of College*, New York Times, May 12, 2012, *available at* http://www.nytimes.com/2012/05/13/business/student-loans-weighing-down-a-generation-with-heavy-debt.html?pagewanted=all (accessed May 12, 2013). The article profiles a 2012 graduate of Ohio Northern University works two jobs to pay off $120,000 loan and lives at home with his parents.

[4] Mary Pilon, *The $550,000 Student-Loan Burden*, Wall Street Journal, February 13,2010, *available at* http://online.wsj.com/article/SB10001424052748703389004575033063806327030.html#printMode (accessed August 17, 2012).

design at a for-profit college.[5] By graduation, her debt had grown to over $100,000. She could not find a job in her field and obtained several forbearances, incurring additional interest and fees. She eventually landed a job in a different field and after making timely payments for five years, she still owes $98,000. When the loans are paid in 25 years, she will have paid $211,000. She figures that for now she cannot afford to study for a business degree, start her own business, own a house, or have children. Excessive student debt is even a factor in who people will date or marry.[6] I've have interviewed a number of student loan debtors. Here are a few stories:

1. Debtor 1

Debtor 1 is in her mid-30s and has dual degrees in music education and music therapy from a private non-profit music school, which she attended over 14 semesters from 2003 to 2008. With tuition costs of $10,000 per semester, living costs of $13,000 per year, and fees, insurance, instruments, a computer, and other items required by the school, she borrowed $202,600, including $138,500 in private loans and $64,000 in state and federal loans. Debtor 1 had no music training before she enrolled, and no audition was required. Admissions personnel assured her she could readily find contract work in music therapy at $60 per hour, but no such jobs have ever materialized. And, she cannot work in music education because she cannot afford to perform the four-months of unpaid internship plus purchase the six credits that state licensing would require. Unable to find work in her field after graduation, Debtor 1 is employed as a switchboard operator for a large company where she makes $29,800 per year. After taxes and modest living expenses, she has $124 per month for debt service. For years following graduation, she struggled to make loan payments and worked with her lenders to restructure payments. Finally, after going into default on her private loans and with judgments looming, she filed Chapter 13 bankruptcy in 2011. As of the petition date, with interest the debt had mushroomed to $248,600. During her bankruptcy she will not be making regular loan payments, so interest on the debt will continue to accumulate.

When asked about how she could have allowed so much debt to accumulate, Debtor 1 has several answers. First, coming from a blue-collar background, she knew essentially nothing about finances, making a living, and paying back debt. Higher education was perceived as the key to a meaningful career and lifetime earning potential. It did not occur to her to consider the amount of debt she was accumulating until she was several years into her program, and by then, with so much invested, it was unthinkable not to continue. Second, borrowing, especially from private sources, was absurdly easy. Two loan sources, Citibank and TERI, supplied all of her private loans, and it took only ten minutes online per semester to borrow anywhere from $10 to $20 thousand. She was not even required to provide her real signature. One lender required a parent to co-sign each loan, but after obtaining an initial electronic signature from her father, the lender did nothing to verify that the parent had, in fact, agreed to co-sign subsequent loans. It was only after Debtor 1defaulted that the father who had electronically co-signed one loan

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[5] Sue Shellenbarger, *To Pay Off Loans, Grads Put Off Marriage, Children*, Wall Street Journal, April 17, 2012, *available at* http://online.wsj.com/article/SB10001424052702304818404577350030559887086.html (accessed, April 18, 2012).

[6] Jennifer Ludden, *Call me Maybe When Your School Loan Is Paid In Full*, NPR, July 16, 20120, *available at* http://www.npr.org/2012/07/16/156736915/call-me-maybe-when-your-school-loan-is-paid-in-full (accessed August 24, 2012).

learned about the other loans for which he was obligated. Tragically, her father has not communicated with her since that time.

Debtor 1 compartmentalizes the fact that she owes so much, and while she imagines that she will one day be out of debt, there seems to be no feasible way this will ever happen. In the meantime, she has friends, a pet, and a very modest social life. She does not own a home or a car, nor does she have credit cards. She does not expect her situation to change to any time in the foreseeable future.

2. Debtor 2

Debtor 2 is in her mid-30s and has three children under the age of 15. Her annual income of $30,700 comes from social security disability, child support, and food stamps, and is well below the state minimum where she lives. Her rental payment of $550 a month is half the IRS average for a family of four in her area, and all her other allowable expenses (food, clothing, medical, utilities, etc.) are at or below the IRS guidelines. Nevertheless, Debtor 2's allowed expenses of $2,565 per month exceed her monthly income by $2.00. Additionally, two of her children have special medical conditions that require frequent hospitalization, and Debtor 2 must care for them around the clock.

Debtor 2 enrolled in a medical training program, but was unable to complete it because of parenting demands. Unfortunately, she borrowed $17,200 in student loans when she was in the program. With expenses in excess of her social security income, Debtor 2 is unable to pay any of her debt. When she filed for bankruptcy, she also filed an adversary proceeding to have the student loan debt discharged. The creditor answered the complaint and started discovery, including a deposition and interrogatories and requests for production of documents. Among the information requested were documents regarding her medical condition and that of her children. Debtor 2 could not afford the cost to copy all the records, and through her lawyer, offered to provide authorization for the creditor to obtain its own copies. At the conclusion of her deposition, counsel for the creditor told Debtor 2's attorney that as it appeared that she was disabled and unable to pay the debt, he would recommend that his client agree to the discharge and therefore it was not necessary for Debtor 2 to provide any documents or even to proceed with administrative remedies such as income contingent repayment. However, the creditor later refused to agree to the discharge, in part because Debtor 2 had failed to provide documents to establish her medical condition. Ultimately, Debtor 2 entered into an income based repayment program. Based on her income, her payments are $0, so the result is might seem the same as discharge of the debt. However, under IBR, Debtor 2 must provide extensive medical and financial information to prove her condition each year. For her it would have been far easier and less stressful for her if the creditor had agreed to the discharge.

3. Debtor 3

Debtor 3 is in her late 40s and lives in a modest condominium in a Midwestern city. She received a BFA degree at a prestigious university in 1989, for which she incurred a loan for $11,000 from the Department of Education. In addition, she used credit cards to supplement college costs, and, as she says, "to have a bit of fun during the summers." Debtor 3's first job after college was working in a diner, but eventually she found work in electronic printing. Still, the salary was low and she did not make many payments on her loan. Financially strapped with student loans and credit card debt, Debtor 3 filed a pro se bankruptcy in 1990. She received a discharge in 1991. Debtor 3 says that the standard discharge order was confusing, so she wrote to the judge to confirm that all claims on the list of creditors had been discharged. He returned a handwritten response at the bottom of her letter that said simply "your case was granted," which she took to mean in the debts had been discharged.

Following the bankruptcy, and assuming that her student loan debt had been discharged, and Debtor 3 made no further payments. She even got all references to the loan removed from her credit report, which to her confirmed that the debt was discharged. Nevertheless, student loan collectors continued to call and send collection letters. Sometimes Debtor 3 responded with snarky letters of her own, but she continued to assume that the debt had been discharged. However, in 1998 the Department of Education levied on her tax return, and it has continued to do so ever since. A collection agency began pursuing her in earnest starting in 2006, eventually garnishing her wages. For a time, the Department of Education granted her requests for a hardship deferral, but after two years refused to allow any further deferment. Along the way, Debtor 3 studied for and received an MFA in the hopes that it would improve her career prospects. That resulted in an additional $5,000 student loan owed to a private lender, but the new degree did not enhance her career prospects.

In recent years Debtor 3 has taught part-time and worked in a variety of temporary jobs, but has been unable to find permanent work. She earns sporadic income from process serving, selling art, and even paid medical testing. Debtor 3 has also used credit cards to purchase basic necessities. When her unemployment benefits ran out in 2011, Debtor 3 filed a second pro se Chapter 7. By that time, her federal student loan debt had grown to $25,000, and she still owed $2,000 in private student debt. She filed a pro se adversary proceeding against both lenders seeking discharge for undue hardship under the *Brunner* criteria. The private lender did not respond, so the court granted default judgment. This is not a surprising, given that the cost of retaining counsel and responding to the complaint would cost more than the amount owed. But the Department of Education has respond to Debtor 3's complaint, discovery is on-going.

4. Debtor 4

Debtor 4 is a recent law school graduate. Unlike the other debtors profiled above, he has not filed bankruptcy and does not anticipate doing so. But his story is typical of tens of thousands of recent law grads, so it is worthwhile presenting it here. Debtor 4 had no undergraduate student debt and worked at a steady job in business making $50,000 per year for five years before starting law school. He was not dissatisfied with that income, but was bored and felt his upside prospects were limited, so he decided to attend law school. To pay for law school, Debtor 4 incurred between $189,000 and $191,000 in debt (he is not certain of the exact amount). He received two loans each year during law school: a Grad Plus loan of $40,000 per year that went directly to the law school, and a Stafford loan of $21,000 per year, which covered his living and other expenses. The amount of his debt is so large that it feels amorphous and almost unreal. He currently has a deferment, but Debtor 4 calculates that when it runs out his payments will be $1,200 to $1,500 per month. Right now, however, he is just worried about paying rent and other basic expenses. Despite solid grades in law school, works two temporary legal jobs netting $2,000 per month. Debtor 4 will take a permanent position wherever he can get it. When asked if he is glad he went to law school, Debtor 4 says yes, but that he is "one of the few who is." Notwithstanding his financial worries, Debtor 4 enjoys legal studies and law work, and is confident that his training and abilities portend a bright future.

AN INTRODUCTION TO THE FEDERAL DIRECT CONSOLIDATION LOAN PROGRAM, LOAN CANCELLATION PROCEDURES AND LOAN FORGIVENESS PROGRAMS

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AN INTRODUCTION TO THE FEDERAL DIRECT CONSOLIDATION LOAN PROGRAM, LOAN CANCELLATION PROCEDURES AND LOAN FORGIVENESS PROGRAMS

Edward M. ("Ted") King[1]

I. Introduction to U.S. Department of Education's Federal Direct Consolidation Loan Program.

If your clients borrowed money to help pay for their after high school education and they still owe money on these loans, the U.S. Department of Education's Federal Direct Consolidation Loan Program (Direct Consolidation Loan Program) and Income Based Repayment Plan may help you help them manage their loan repayment and may obviate the need to file a non-dischargeability action to determine the dischargeability of these student loan obligations. The William D. Ford Federal Direct Loan Program ("Direct Loan Program") was created to give students a less complicated way to consolidate educational loans. Direct consolidation Loans have only one lender to be repaid – the U.S. Department of Education ("ED").

The Direct Consolidation Loan Program is designed to help borrowers manage and repay the money they borrowed to pay for postsecondary education. A Direct Consolidation Loan allows a borrower to combine one or more federal education loans into a new loan that offers several advantages.

II. Advantages of a Direct Consolidation Loan

A Direct Consolidation loan offers many advantages. Among them:

A. Affordability

By consolidating their education loans, borrowers may be able to extend their loan repayment period. Extending their repayment period reduces borrowers' monthly payments. However, if it takes longer to repay the loan, the borrower will pay more interest and, therefore, a higher total amount over the life of the loan. Further, consolidation fixes a currently variable interest rate by providing a fixed rate at a weighted average of current loan rates. So to the extent variable rates increased, the consolidated loan's rate would not rise.

[1] Member, Frost Brown Todd LLC, Louisville, KY. The author is grateful for the assistance of Julie K. Swedback, Senior Attorney, Educational Credit Management Corporation in the preparation of these materials and his remarks.

B. Flexibility

When borrowers consolidate their loans, they gain financial flexibility. They can choose from several different repayment plans and change their repayment plan as financial circumstances change. They pick the plan that best fits their needs.

C. Efficiency

A Direct Consolidation Loan also permits borrowers to consolidate loans from different lenders. If they have different types of loans (subsidized and unsubsidized student loans), they may consolidate all of them into a single consolidation loan. The borrowers will receive only one monthly bill.

There are no loan fees charged, and there are no minimum or maximum loan amounts in the Direct Consolidation Loan Program.

D. Convenience

By consolidating their education loans, borrowers simplify their loan communication requirements. They will have only one place to send their monthly payment and only one phone call to report a change of address or phone number, request a deferment, or ask a question about their loan(s).

E. Deferral and Forbearance Options

Borrowers who consolidate their loans into the Direct Consolidation Loans again become eligible for deferments and forbearances, even if their current loans are defaulted.

F. Public Service Loan Forgiveness Program Eligibility; Servicemember Benefits

Borrowers who consolidate with Direct Consolidation Loans are eligible for the Public Service Loan Forgiveness Program. Further, members of the armed services may receive a reduced interest rate or no accrual of interest during periods of qualifying active duty military service.

III. Consolidating Defaulted Student Loans

If the borrower is in default in the Federal Family Education Loan Program ("FFELP"), the borrower can consolidate the loan into any of the Ford's Program's payment options including the Income Contingent Repayment Program (the "ICRP") or the Income Based Repayment Program (the "IBR").

Collection costs on currently defaulted FFELP loans are reduced to 18.5% of the principal and interest balance on loans that are consolidated into the Ford Program. Under current regulations, this could mean a savings of 6.5% on the total loan amount.

Note:

- If a judgment has been issued, the judgment must be released.
- If, before applying for consolidation, borrowers want to completely clear the default notation on from their credit record, they may want to consider another option – loan rehabilitation.

IV. Repayment of Direct Consolidation Loans

A. First Payment

The first payment on a Direct Consolidation Loan will be due within 60 days of the first disbursement.

B. Payment Period

The length of time a Direct Consolidation Loan will be in repayment will vary depending on the total amount of the loans and the repayment plan a borrower selects.

C. Prepayment

A borrower may prepay all or any portion of a Direct Consolidation Loan at any time without penalty.

V. Repayment Options

In most cases, a borrower may chose to repay a Direct Consolidation Loan through one of four repayment plans:

A. Standard Repayment Plan

B. Extended Repayment Plan

C. Graduated Repayment Plan

D. Income Contingent Repayment Plan

Note: PLUS Loans are now eligible for repayment under the ICRP

If a repayment plan is not selected, the Direct Consolidation Loan will be placed on the Standard Repayment plan.

Borrowers who believe that none of the available plans are feasible may petition the Secretary of Education for an alternative repayment plan.

E. Income-Based Repayment Plan

VI. Some Distinguishing Factors and a Summary of the Plans

A. Length of Repayment

1. Standard Repayment Plan – Up to 30 years, depending on the loan balance

2. Extended Repayment Plan – 12-30, depending on the loan balance.

3. Graduated Repayment Plan – 12-30 years, depending on the loan balance.

4. Income Contingent Repayment Plan – Up to 25 Years

5. Income-Based Repayment Plan – Up to 25 Years

B. Standard Repayment Plan

With standard repayment, borrowers make a fixed payment of at least $50 a month for up to 30 years. For some borrowers, this plan results in the lowest total amount of interest paid because the repayment period is shorter than it would be under the other plans. In general, the shorter the repayment period, the lower the total interest payment.

C. Extended Repayment Plan

With extended repayment borrowers make fixed payments of at least $50 a month over a period that varies from 12 to 30 years, depending on the total amount of their Direct Consolidation Loan and other allowable education loans.

Because the borrower will take more than 10 years to repay the loan under the extended plan, the monthly payment will be less than under the Standard Repayment Plan. However, the total amount they paid will be greater because they pay more interest.

D. Graduated Repayment Plan

With graduated repayment, payments start out low, then increase, generally every two years. The length of the repayment period will vary from 12 to 30 years and depends on the total amount of the Direct Consolidation Loan and other allowable education loans.

This plan might be right for borrowers who expect their income to increase steadily over time. The minimum monthly payment will be the greater of the interest that accumulates on the loan between payments, or half of the payment the borrower would make each month under the Standard Repayment plan. However, the monthly payments will never be more than one-and-one-half times what the borrower would pay under standard repayment. Generally, the amount a borrower will repay over the term of his or her loan will be higher under graduated repayment than under extended repayment. However, graduated repayment has the advantage of offering lower payments earlier in the borrower's career where income may be lower.

E. Income Contingent Repayment Plan

1. General

With the ICRP, a borrower's monthly payments will be calculated on the basis of his annual income and the total amount of his Direct Loans.

2. Parental PLUS Loans Eligible. Recently, the Department of Education changed its longstanding policy that prohibited consolidation of Parental Loans for Undergraduate Students ("PLUS Loans") into the ICRP. This meant that a parent could not consolidate loans into the ICRP and then retire and have a minimal adjusted gross income and thereby a minimal monthly payment. However, this policy is no longer in effect and this is a great benefit for borrowers who have PLUS Loans.

3. Capitalization of Interest

If the payments are not large enough to cover the interest that has accumulated on a borrower's loans, the unpaid interest will be capitalized once each year. This means that the unpaid interest will be added to the principal owed. If capitalization increases the total amount owed to 10 percent more than the original amount owed when the borrower entered repayment, interest will continue to accumulate but will no longer be capitalized.

4. Repayment Period/Cancellation of Balance

The maximum repayment period is 25 years. This is the important part: if the borrower hasn't fully repaid his loans after 25 years under this plan, the unpaid portion will be cancelled. However, the borrower may have cancellation of indebtedness income on the amount that is cancelled.

Under this plan the borrower will pay an amount based on the Adjusted Gross Income ("AGI") his household reports on his federal tax return. If he is married, the amount he pays will be based on his income and his spouse's income.

5. Payment Amounts Based on "Discretionary Income"

The amount a borrower will pay will never be greater than 20 percent of his discretionary income. This is AGI minus the poverty level for his family size. The required payment amount will actually be the lesser of (a) 20% of Discretionary Income and (b) the amount the borrower would repay annually over 12 years using a standard amortization multiplied by an income percentage factor that varies with the borrower's AGI.

6. Treatment of Spouse's Income.

The income of a borrower's spouse will always be counted in the AGI calculation, whether or not the spouse files jointly with the borrower or separately.

7. Discretionary Income = AGI – Poverty Level for Family Size

8. Interest Rate is Weighted Average.

A borrower's interest rate for a direct consolidation loan is based on the weighted average of all loans consolidated.

9. Alternative Documentation of Income

A borrower will be required to submit alternative documentation of his current income (that is, other than IRS-reported AGI) to the Department of Education. Such documentation includes pay stubs, canceled checks, or, if these are unavailable, a signed statement explaining the borrower's income sources. The form also has a box to check if the borrower has no taxable income and/or does not file a tax return.

In addition, a borrower may choose to submit alternative documentation of current income if special circumstances, such as loss of employment for the borrower or his spouse, warrant an adjustment to his monthly payment.

11. Payment Calculator; Payment Amounts

A great payment calculator for the ICRP can be found at:

https://loanconsolidation.ed.gov/loancalc/servlet/Controller?controller_task=startCalculator

It shows the total monthly payment and even shows the total payments throughout the term of the loan so that borrowers can see whether there is some forgiveness of their loan balance if they pay for the 25 year period and there is a balance left.

If a borrower's income is less than or equal to the poverty level for his family size, his monthly payment will be zero. If a borrower's calculated monthly payment is greater than zero but less than $5, he will be required to make a $5 monthly payment.

F. Income-Based Repayment Plan.

1. General

Like the ICRP, a borrower's monthly payments under the Income-Based Repayment Plan will be calculated on the basis of his annual income and the total amount of his Direct Loans.

To qualify for the IBR, borrowers must first demonstrate partial financial hardship. Borrowers can demonstrate partial financial hardship if the annual amount due on all eligible student loans under a 10-year repayment schedule is more than 15% of their adjusted gross income minus 150% of the federal poverty guideline for the applicable family size. Most borrowers whose total loan balance exceeds their annual earnings will satisfy the partial financial hardship requirement

2. Treatment of Married Borrowers Filing Separately

With the Income-Based Repayment Program, the income of a non-borrower spouse who files a separate income tax return is not counted in the calculation of AGI but the non-borrower spouse is still counted in the family size. This can be a great benefit to low to moderate income borrowers with higher income spouses who can afford to file separately.

3. <u>Capitalization of Interest</u>

Same as ICRP

4. <u>Repayment Period/Cancellation of Balance</u>

Same as ICRP. However, Congress passed legislation in 2010 that applies to IBR loans taken out after July 1, 2014. For those loans, the maximum repayment period (and the period after which the loan would be cancelled) is only 20 years, rather than 25.

Under this plan the borrower will pay an amount based on the Adjusted Gross Income (AGI) his household reports on his federal tax return. If he is married filing jointly, the amount he pays will be based on household income. If his spouse also has federal student loan debt, the IBR payment based on household income will be prorated over the set of loans. But if he is married filing separately, he may still count his spouse and any dependents in the calculation of family size, but the IBR amount he pays will be based only on his income and the IBR payment will be applied to his loan only.

5. <u>Payment Amounts Based on "Discretionary Income"</u>

The amount a borrower will pay will never be greater than 15 percent of his discretionary income. This is AGI minus 1.5 times the poverty level for his family size. This often results in a lower payment than under the ICRP, which is 20 percent of AGI minus the poverty level for the family size. And family size includes the spouse, whether or not the spouse files a joint return.

The 2010 legislation described above regarding the 20 year repayment period also lowers the percentage of discretionary income that must be paid towards the loan from 15 percent to 10 percent.

6. <u>Discretionary Income = AGI – (1.5 x Poverty Level for Family Size</u>)

7. <u>Payment Calculator; Payment Amounts</u>

A great payment calculator for the IBR can be found at:

https://loanconsolidation.ed.gov/loancalc/servlet/Controller?controller_task=startCalculator

If a borrower's income is less than or equal to the poverty level for his family size, his monthly payment will be zero. If a borrower's calculated monthly payment is greater than zero but less than $5, he will be required to make a $5 monthly payment. If it is more than $5 but less than $10, it will be a $10 monthly payment.

VII. Certain Loan Cancellation Procedures and Loan Forgiveness Programs**.** Student loan borrowers must repay their loans even if they do not complete their education, cannot find a job related to their program of study, or are unhappy with the education they paid for with your loan. However, certain circumstances might lead to loans being forgiven, canceled, or discharged.

A. Total and Permanent Disability Cancelation.

1. Generally. Borrowers may be eligible for a TPD Discharge on their federal student loans if they are unable to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment that (a) can be expected to result in death,(b) has lasted for a continuous period of not less than 60 months, (c) can be expected to last for a continuous period of not less than 60 months; or (d) has been determined by the Secretary of Veterans Affairs to make them unemployable due to a service-connected disability.

2. Conditional Discharge and Monitoring Period. If the application is approved, a discharge is granted and the borrower is then subject to a 3-year post-discharge monitoring period. During this monitoring period, the borrower (a) must not have annual employment earnings that exceed the Poverty Guidelines for a family of two in the borrower's state; (b) must not receive a new Perkins, or Direct Loan or a new TEACH Grant; and (c) must ensure the return of a loan disbursement made before the discharge date, but was disbursed during the 3-year post-discharge monitoring period.

3. For More Information and for an Application. http://www.disabilitydischarge.com

B. Death Discharge.

C. Closed School Discharge.

1. Eligibility. A borrower may be eligible for discharge of federal loans under any of the following circumstances: (a) the school closes while the student was enrolled and the student does not complete the program because of the closure or (b) the school closes within 90 days after the student withdrew.

2. Ineligibility. The borrower may not receive a discharge if her school closes and either (a) she withdrew more than 90 days before the school closes, (b) she is completing a comparable educational program at another school, or (c) she has completed all of the coursework for the program but has not received a diploma or certificate.

D. False Certification of Student Eligibility or Unauthorized Payment Discharge. A borrower may be eligible for a discharge if (1) the borrower's school falsely certified the student's eligibility based on the student's ability to benefit from the school's training and the student did not meet the ability to benefit student eligibility requirements, (2) the school signed the student's name on the application or promissory note without the borrower's authorization or endorsement the school loan check or signed the student's authorization for electronic funds transfer without the student's knowledge, (3) the loan was falsely certified because the student was a victim of identity theft, (4) the school certified the student's eligibility but because of a physical or mental condition, age, criminal record, or other reason, the student is disqualified from employment in the occupation in which the student was being trained.

E. Teacher Loan Forgiveness. Certain borrowers with federal student loans who have been teaching full-time in a low-income elementary or secondary school or educational service agency for five consecutive years, you may be able to have as much as $17,500 of their subsidized or unsubsidized loans forgiven.

F. Public Service Loan Forgiveness. Borrowers who make 120 qualifying payments under the IBR, ICR, or 10-year fixed payment schedule while employed in the public sector are eligible to have any balance remaining on their student loan debt forgiven. Public service includes employment with most local, state, federal, tribunal nation, or § 501(c)(3) corporations. There is specific language in this regulation that exempts any forgiven debt from constituting a taxable event. (Ford Program loans only).

G. Alternative Payment Arrangements. Borrowers who believe that none of the payment options are suitable may request an alternative repayment plan from the Secretary of Education. *See* 34 C.F.R. § 685.208(g).

H. Suspension of Payments**:** In addition to the different types of repayment plans, borrowers may seek deferment of repayment or forbearance. During a deferment period, no interest accrues on subsidized loans but interest continues to accrue on unsubsidized loans. The borrower may pay the interest or have it added to the principal when the deferment expires. Forbearance postpones or reduces the monthly repayment for a limited, specific period, during which interest on the loans accrues. If the interest is not paid, it is added to the principal balance. Forbearance may be granted based upon a borrower's poor health, temporary financial hardship, if the borrower is obligated to make payments on federal student loans that are equal to or greater than 20% of monthly gross income, or other reasons acceptable to ED.

VIII. Additional Resources

National Consumer Law Center, *Student Loan Law: Collections, Intercepts, Deferments, Discharges, Repayment Plans, and Trade School Abuses* (2d ed. 2002).
David J. Light, Esq., *Discharging Student Loans in Bankruptcy* (2d ed. 1999).

IX. Web Sites

Federal Student Aid (government website): (http://studentaid.ed.gov)
Finaid (consumer financial aid website): (www.finaid.org)
Department of Education (www.ed.gov)
Department of Education Ombudsman Office (www.ombudsman.ed.gov)
William D. Ford Direct Loan Program (www.loanconsolidation.ed.gov)
National Student Loan Data System (www.nslds.ed.gov)
ED PIN website: (www.pin.ed.gov)
National Counsel of Higher Education Loan Programs (www.nchelp.org)
Educational Credit Management Corporation (www.ecmc.org)
FFEL Forms: (http://www.ecmc.org/topic/mainForms.html)
Direct Loan (Ford program) Forms: (https://www.dl.ed.gov/borrower)

Student Loan Debt:

Numbers, Drivers, & Profiles

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Associate Professor
Northeastern University School of Law

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Agenda

- Overview of the Student Loan Industry
  - Federal Loan Programs
  - Private Education Loans
- The Numbers
  - Spiraling Education Borrowing
  - Delinquency and Default
  - Spiraling Education Costs
- Drivers of Student Borrowing
- Student Loan Debt in Bankruptcy
- Debtor Profiles
- Concluding Thoughts

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The Student Loan Industry
Overview of Federal Loan Programs

- Designed to make college accessible for all students regardless of economic background
  - Account for 75% of all outstanding education loans and 93% of all loans originated in 2010-2011
- Approximately 80% of federal student loans originated prior to 2010 are serviced by private lenders
  - Little consideration given to a student's creditworthiness
  - "Special allowance rate" provided lenders with a guaranteed rate of return
  - Loan guaranteed by the federal government in the event of default
- Federal student loans are now made directly to students through the U.S. Department of Education as an income-producing endeavor
  - Profit = Nominal Interest Rate on Student Loan – Federal Borrowing Rate
  - 1 % origination fee
  - Projected to generate $36.8 billion of revenue in 2013, providing a return of 20.08% on each dollar lent during the year

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The Student Loan Industry
Federal Loan Programs

- **Subsidized Stafford Loans**
  - 3.4% annual interest rate; interest deferred until graduation
  - Financial needs test based on family income
  - Not available to graduate and professional students
- **Unsubsidized Stafford Loans**
  - 6.8% annual interest rate
  - Available to borrowers at all income levels
  - Interest deferred while in school; accrued interest capitalized upon graduation
- **PLUS Loans (Parents Plus)**
  - 7.9 % annual interest rate; interest accrues upon disbursement
  - Available to parents with dependent undergraduate, graduate, and professional degree students
  - Applicants may not have adverse credit history
- **Consolidation Loans**
  - Available for borrowers with existing loans in order to combine the loans and extend payment schedules and terms
  - Interest rate based on weighted average of all consolidated loans

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The Student Loan Industry
Federal Loan Borrowing Limits

Level	Annual Borrowing Limit	Aggregate Borrowing Limit
Dependent Undergraduate	\$5,500 - \$7,500	\$31,000
Independent Undergraduate	\$9,500 - \$12,500	\$57,500
Graduate Student	\$20,500	\$138,500

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The Student Loan Industry
Private Education Loans

- Approx. \$150 billion of all outstanding student debt and held by 2.9 million students
- No borrowing limits
- Lax lending standards
- No cap on interest rates
- Priced according to credit-worthiness of borrower
- Many loans subject to interest rate adjustment without notice
- No deferments, income-contingent repayment provisions, or any other relief available in federal programs
- Student Loan Marketing Association (Sallie Mae)
- The largest private lender of educational loans – financed by borrowing money and then relending to students at a higher interest rate
- Up to 30% of student debt is securitized in (Student Loan Asset Backed Securities)
  - 1990: \$75.6 million Sallie Mae securities in circulation
  - 2010: \$ 250 billion securities in circulation

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Student Loan Debt
The Numbers

- 37 million Americans (19.9% of households) owe student loans
  - Largely concentrated among young adults under the age of 40
  - Also extends to parents and relatives who co-sign
    - People aged 60+ hold $36 billion in student loan debt (10% delinquent)
- Average student debt burden for a graduate of the Class of 2010:
  - Undergraduate student: $25,250
  - Graduate student: $43,500
  - Law student: $98,500
- Aggregate student loan balance projected to surpass $1 trillion by the end of 2013
  - Larger than consumer credit card debt ($679 billion) and auto loan debt ($737 billion)
  - Less than 40% of loans in repayment status according to original terms
  - 21% of loans delinquent or in default
- Projected 2013 Lending = $150 billion

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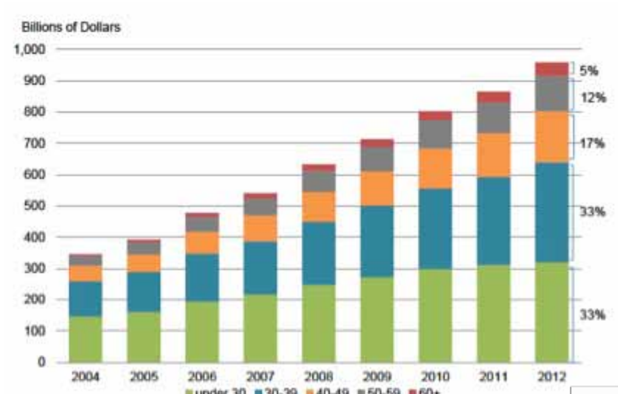
Rapid Growth of Student Debt
2004-2012



- 2012 Aggregate Student Debt of $966 billion
- Student debt has nearly tripled from 2004-2012
- Growth at all age levels
- 70% increase in number of borrowers
- 70% increase in average balance per debtor

Donghoon Lee, *Household Debt and Credit: Student Debt*, Fed. Reserve Bank of N.Y., 2/28/13

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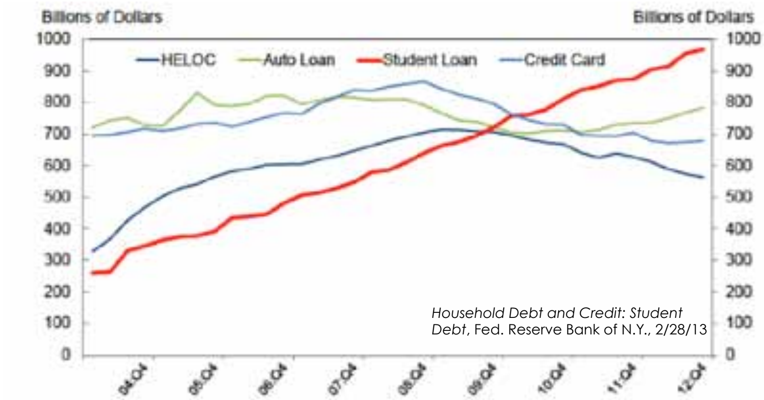
Non-Mortgage Debt Balances

2003-2012



Household Debt and Credit: Student Debt, Fed. Reserve Bank of N.Y., 2/28/13

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Spiraling Education Borrowing

At a Glance

Average Debt Burden
Full-time Undergraduate Students

Year	Public	Private
1989-1990	$8,200	$10,600
1999-2000	$15,100	$16,500
2010-2011	$22,000	$28,100

2010-2011 Average Borrowing
Federal Loan Programs

Institution	Average Loan Amount	% of Students Borrowing
Public, non-profit	$4,907	54%
Private, non-profit	$16,423	66%

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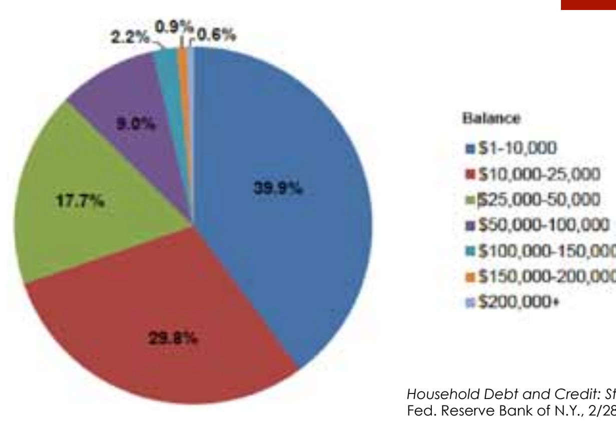
Distribution of Student Loan Balances *2012*



Household Debt and Credit: Student Debt, Fed. Reserve Bank of N.Y., 2/28/13

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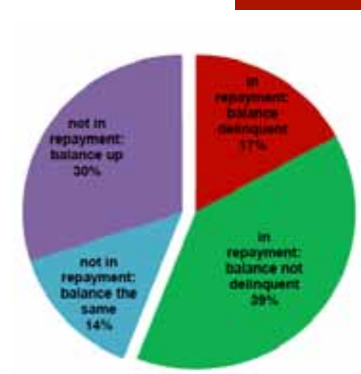
Delinquency & Default

- 44% of borrowers not yet in repayment due to deferments and forbearances
- 17% of borrowers more than 90 days past due (compared to 10% in 2004)
- Transition rate of borrowers in repayment, from current to delinquent, has been steadily rising since 2008
- Less than 40% of loans are in repayment status according to original terms



Household Debt and Credit: Student Debt, Fed. Reserve Bank of N.Y., 2/28/13

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Spiraling Education Costs:
Cause or Effect?

- Since 1990, the cost of education has mushroomed far in excess of the cost of living:

January 2000
- CPI = 100
- Cost of Education = 100

July 2012
- CPI = 135
- Cost of Education = 196

- Overall, the cost of education has risen by THREE times the cost of inflation since 1983

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Spiraling Education Costs:
Cause or Effect?

Average Cost
Tuition, Room, and Board

	Public Four-Year University	Private Four-Year University
1990-1991	$8,403	$21,218
2000-2001	$10,609	$26,795
2011-2012	**$17,131**	**$38,589**

- Estimated growth in annual tuition over the past decade:
  - Community College: 40% (to $3,122)
  - Four-Year Public University: 68% (to $7,692)

Charles M. Blow, *A Dangerous 'New Normal' in College Debt*, N.Y. Times, 2/8/13

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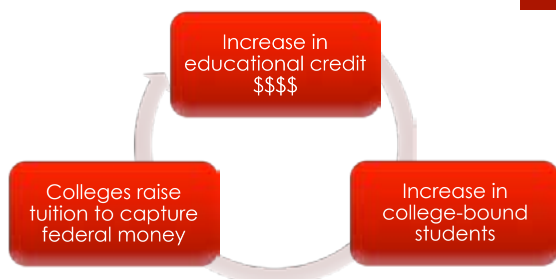
"The Bennett Hypothesis"

Cause, Effect, Cause Again



"Increases in financial aid in recent years have enabled colleges and universities to raise their tuitions, confident that the Federal Government loan subsidies would help cushion the increase."

- William Bennett, U.S. Secretary of Education (1985-1988)

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Drivers of Student Borrowing

A Confluence of Trends

- Dramatic rise in tuition for higher education
  - More people attend college and graduate school
  - Students stay longer
- Drop in state and local funding:
  - 2001: $8,670 per student
  - 2012: $5,896 per student
- Median household income falling:
  - 7% decline from 2001-2011
- Parents are increasingly funding children's education through supplemental loans:
  - 1992: 5.6% of parents took out loans
  - 2010: 17% of parents took out loans
- Lower repayment rates as borrowers delay payments through deferments and forbearances
- Today's college graduates face bleak job prospects:
  - 48% of college graduates in job that requires <u>*less than*</u> a college education
  - Of which, 37% of college graduates are in an occupation that requires no more than high school diploma

Charles M. Blow, *A Dangerous 'New Normal' in College Debt*, N.Y. Times, 2/8/13

- Student loans are notoriously difficult to discharge
  - Senior to all other consumer debt
  - Few debtors pursue discharge for undue hardship in bankruptcy (3 of 814 cases)
- Lax lending standards
  - Little consideration given to a student's job prospects upon graduation or ability to repay
- Over half of borrowers fail to exhaust federal resources before seeking private education loans

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Undue Hardship Discharges

In Chapter 7 and Chapter 13 Bankruptcy Cases

- Audit of 3,750 randomly-selected chapter 7 and chapter 13 bankruptcy cases spanning 10 jurisdictions across the country
- Student loan debt reported in 814 of these cases (21.7 %)
- Observations:
  - Peaked in 2009 at the height of the recession, back on the rise by 2011
  - Debtors filed adversary proceedings to have student debts discharged on the ground of undue hardship in *only three cases*
  - Research suggests that nearly half of debtors who filed an adversary proceeding for an undue hardship discharge were successful in securing some degree of relief
  - Debtors who did obtain a student loan debt discharge were likely to have a medical problem or a dependent with a medical problem, be unemployed, and have nominal or no income in the year prior

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Spiraling Education Borrowing

In Chapter 7 Bankruptcy

Year	% With Student Debt	Average Balance of Student Loan Debt
2004	18.0	$ 18,424
2005	18.9	$ 12,545
2006	19.0	$ 16,644
2007	23.2	$ 21,055
2008	19.9	$ 28,213
2009	21.8	$ 29,992
2010	21.3	$ 21,360
2011	24.3	$ 25,096

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Spiraling Education Borrowing

In Chapter 13 Bankruptcy

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Year	% With Student Debt	Average Balance of Student Loan Debt
2004	14.6	$ 13,332
2005	14.7	$ 23,208
2006	22.2	$ 16,304
2007	22.1	$ 21,699
2008	19.1	$ 17,497
2009	22.0	$ 26,908
2010	24.2	$ 24,396
2011	22.3	$ 26,483

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Debtor Profiles

Debtor 1 – Unable to work in field of study

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- Woman in her mid-30's with dual degrees in music education and music therapy
- Studied at a private music school for 14 semesters from 2003 – 2008
  - Tuition Costs: $10,000 per semester
  - Annual Living Costs: $13,000
  - Additional fees, insurance, instruments, computer, other required expenditures
- Total Student Loan Debt of $202,600
  - $138,500 in private loans
  - $64,100 in state and federal loans
- Unable to find work in either field upon graduation
- Found work as a switchboard operator earning $29,800 annually
- Filed for Chapter 13 bankruptcy in 2011
  - $248,600 in principal and capitalized interest
- **Reflections and Observations**
  - Debtor came from a blue-collar background and had little in the way of financial training or literacy
  - Little thought given to the amount of debt that she'd incurred until several years in
  - Borrowing, especially from private sources, "absurdly easy"
    - Online registration
    - No signature or verification of co-signers required
  - Outlook:
    - No credit card
    - No car
    - No home ownership
    - No expectation that her modest lifestyle will change in the near future

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Debtor Profiles

Debtor 2 – The recent law school grad

- Recent law school graduate in his early 30's
- No undergraduate debt and worked for 5 years prior to law school, earning $50,000 per year
- Financed legal education with $189,000 - $191,000 in student loans
  - Tuition: $40,000 Grad PLUS loan
  - Living Expenses: $21,000 Stafford loan
- Despite solid grades, unable to find permanent employment upon graduation
- Works two temporary legal jobs, netting $2,000 per month
- Willing to take permanent position wherever he can get it
- Currently has a deferment, but calculates that payments will run between $1,200 and $1,500 per month
- Has not yet filed for bankruptcy, does not intend to
- **Observations:**
  - The amount of debt owed is so large that if feels "amorphous" and "almost unreal," yet he remains optimistic
  - Glad that he went to law school, but he is "one of the few who is"
  - Story is typical of tens of thousands of recent law school graduates

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Concluding Thoughts

- Our national educational aspirations are on a collision course with the debt crisis that they're creating
- Crushing student loan debt, coupled with a struggling economy and weak job market, has us on an unsustainable trajectory with long-term social and economic implications for young people and their families
- Is a bubble forming? If so, when will it burst?
- Is this the "New Normal"?
- Retirement and healthcare costs compete for limited public resources and simultaneously drive up the cost of higher education
- State support for higher education continues to fall
- Students and their families must make increasingly greater financial sacrifices to complete a postsecondary education
- Schools and colleges are expected to increase productivity while absorbing larger and larger budget cuts, yet they must maintain quality and increase production

Charles M. Blow, *A Dangerous 'New Normal' in College Debt*, N.Y. Times, 2/8/13

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ABI Student Loan Webinar

Craig Zimmerman
(Debtor Options in Bankruptcy)

In Re Jorgenson 49 B.R. 79 (Sept. 2012)

- Debtor is diagnosed with pancreatic cancer -2010
- Is a professor in University of Hawaii
- Gets treatment in Texas
- While in Texas buys new car - 2011
- File BK Ch 7 2012
- Files Pro Per adversary proceeding to discharge student loans

Debtor's Budget

- $1,450 for rent but is not paying it while teaching in Paris
- $362.73 monthly car payment
- $800 for reoccurring medical expenses
- $625 per month for food (amended up from $500)
- $150 per month on clothes as Debtor lost a lot of weight due to cancer
- Overall Negative Monthly Budget

Student Loan Creditor Arguments

- Debtor is eligible for IBR so should not get discharge
- Debtor didn't prove "undue hardship because the following expenses are too high.
  - Food
  - Clothing
  - Dry cleaning, travel and miscellaneous expenses
  - The new car

Additional Creditor Argument

- Debtor didn't prove cancer return was more than a mere "probability"
- Debtor was cancer free per doctors but still had many health issues as result of cancer and treatment

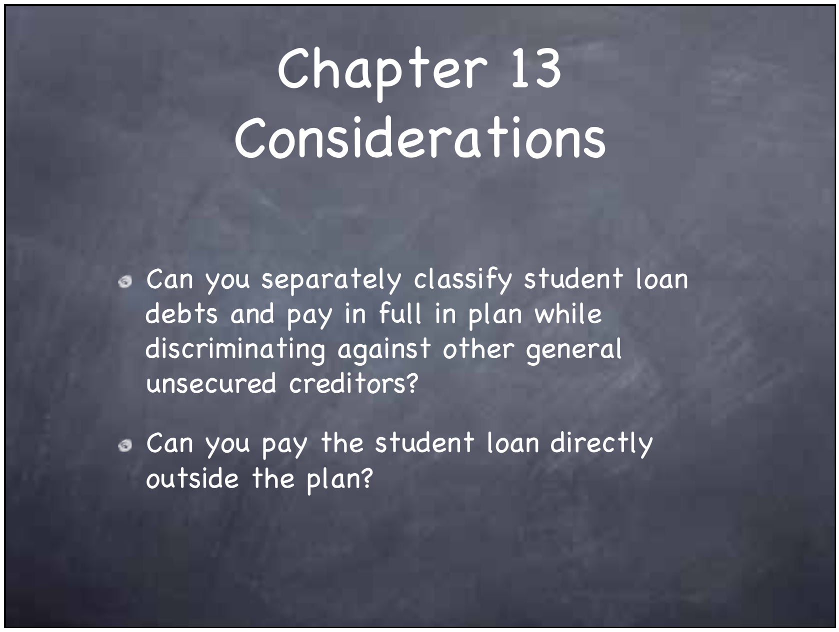
Court Does Partial Discharge

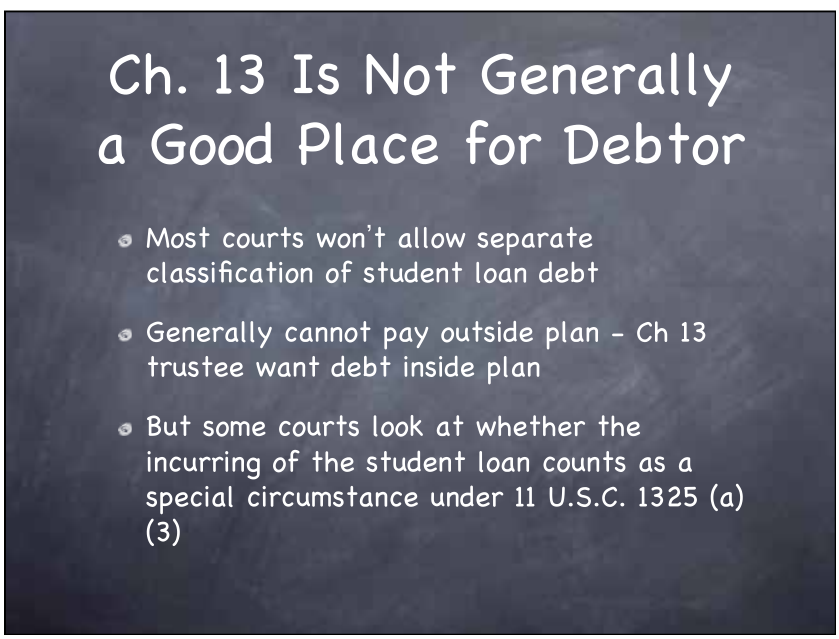
- Very intensive review of facts
- Makes Debtor pay back value of housing and car while in Paris
- Decision somewhat punitive against Debtor

Student Loan Discharge is not easy or inexpensive

Bad Facts Make Bad Law

- In Re Watson Kansas BK Case
- Debtor is in Leavenworth and files BK and adversary to discharge student loan debt
- Says has no ability to earn living as a convicted sex offender
- Court rules student loan debt non-dischargeable
- No sympathy for Debtor


Chapter 13
Considerations
Can you separately classify student loan debts and pay in full in plan while discriminating against other general unsecured creditors?
Can you pay the student loan directly outside the plan?


Ch. 13 Is Not Generally a Good Place for Debtor
Most courts won't allow separate classification of student loan debt
Generally cannot pay outside plan - Ch 13 trustee want debt inside plan
But some courts look at whether the incurring of the student loan counts as a special circumstance under 11 U.S.C. 1325 (a)(3)

An Introduction to the Federal Direct Consolidation Loan Program, Loan Cancellation Procedures & Loan Forgiveness Programs

Edward M. ("Ted") King
Frost Brown Todd LLC
Louisville, Kentucky and Indianapolis, Indiana

Advantages of a Direct Consolidation Loan

- Affordability
- Flexibility
- Efficiency
- Convenience
- Deferral and Forbearance Options
- Public Service Loan Forgiveness Program Eligibility; Service Member Benefits

Consolidating Defaulted Student Loans

Repayment of Direct Consolidation Loans

- First Payment
- Payment Period
- Prepayment
- Repayment Options
  - Standard Repayment Plan
  - Extended Repayment Plan
  - Graduated Repayment Plan
  - Income Contingent Repayment Plan
  - Income-Based Repayment Plan

Distinguishing Factors and a Summary of the Plans

- Length of Repayment
  - **Standard Repayment Plan –** Up to 30 years, depending on the loan balance
  - **Extended Repayment Plan –** 12 to 30 years, depending on the loan balance
  - **Graduated Repayment Plan –** 12 to 30 years, depending on the loan balance
  - **Income Contingent Repayment Plan –** Up to 25 years
  - **Income-Based Repayment Plan –** Up to 25 years

Distinguishing Factors and a Summary of the Plans

- Standard Repayment Plan
- Extended Repayment Plan
- Graduated Repayment Plan
- Income Contingent Repayment Plan
  - Generally
  - Parent PLUS Loans Eligible
  - Capitalization of Interest
  - Repayment Period/Cancellation of Balance
  - Payment Amounts Based on "Discretionary Income"
  - Treatment of Spouse's Income
  - Discretionary Income = AGI – Poverty Level for Family Size
  - Interest Rate is Weighted Average
  - Alternative Documentation of Income
  - Payment Calculator; Payment Amounts

Distinguishing Factors and a Summary of the Plans

- Income-Based Repayment Plan
  - General
  - Treatment of Married Borrowers Filing Separately
  - Capitalization of Interest
  - Repayment Period/Cancellation of Balance
  - Payment Amounts Based on "Discretionary Income"
  - Discretionary Income = AGI – (1.5 x Poverty Level for Family Size)
  - Payment Calculator; Payment Amounts

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Certain Loan Cancellation Procedures and Loan Forgiveness Programs

- Total and Permanent Disability Cancelation
  - Generally
  - Conditional Discharge and Monitoring Period
  - More Information and Application: http://www.disabilitydischarge.com
- Death Discharge
- Closed School Discharge
  - Eligibility
  - Ineligibility

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Certain Loan Cancellation Procedures and Loan Forgiveness Programs

- False Certification of Student Eligibility or Unauthorized Payment Discharge
- Teacher Loan Forgiveness
- Public Service Loan Forgiveness
- Alternative Payment Arrangements
- Suspension of Payments

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Faculty Biographies

Prof. Daniel A. Austin is an associate professor at Northeastern University School of Law in Boston, where he teaches bankruptcy and commercial law. He is the author of "Bankruptcy and the Myth of 'Uniform Laws,'" 42*Seton Hall Law Review* 1081 (2012), and co-author of *Reaffirmation Agreements in Consumer Bankruptcy Cases* (ABI, 1st ed. 2009 and 2d ed. 2010), and he has written numerous articles. Prof. Austin is a member of the Pennsylvania Bar and practiced bankruptcy and commercial law for 16 years prior to joining the faculty at Northeastern. He received his J.D. from Columbia Law School and his Ph.D. from the University of Pennsylvania.

Edward "Ted" M. King is an attorney with Frost Brown Todd LLC in Louisville, Ky., where he is a member of the firm's bankruptcy and restructuring and commercial transactions practice groups. He represents debtors, creditors and committees in insolvency proceedings and assists clients in complex business bankruptcy matters, such as developing plans of reorganization and advising on strategies to maximize recoveries for clients at all stages of the bankruptcy process. In transactional matters, he concentrates in all aspects of financing and secured transactions, leasing, structured financings, workouts and reorganizations and general corporate practice. Prior to joining Frost Brown Todd LLC, Mr. King clerked for Hon. William C. Lee, U.S. District Judge for the Northern District of Indiana. Certified in Business Bankruptcy by the American Board of Certification, Mr. King has been recognized in *The Best Lawyers in America* for his outstanding reputation and distinguished work in bankruptcy and creditor/debtor rights law and was recently selected in *Kentucky Super Lawyers* in banking and in bankruptcy and creditor/debtor rights. He received his A.B. *magna cum laude* from Wabash College and his J.D. *magna cum laude* from Indiana University School of Law, during which time he was a senior notes editor for the *Federal Communications Law Journal* and a research assistant to Prof. William J. Hicks.

Nina M. Parker is the founder of Parker & Associates, a full-service law firm in Winchester, Mass., where she concentrates in the areas of consumer and corporate bankruptcies, specializing in small business and individual chapter 11 plans of reorganization, chapter 13 wage-earner plans and other insolvency options. She has been a member of the bar since 1981, is certified in Consumer Bankruptcy Law by the American Board of Certification and is admitted to practice in Massachusetts, the U.S. District Court of Massachusetts, the U.S. Court of Appeals for the First Circuit and the U.S. Supreme Court. Ms. Parker has served as bankruptcy section co-chair of the Boston Bar Association (2009-11) and currently serves as co-chair of its Diversity Initiative Working Group. She is co-chair of ABI's Consumer Committee, is a member of the ABI Civility Task Force and the Northeast Consumer Bankruptcy Conference Advisory Board and previously served as the ABI Membership Relations Director for the Consumer Committee. In addition, Ms. Parker is a member of the U.S. Bankruptcy Court for the District of Massachusetts' Attorney Advisory Committee for the Local Rules, the *Pro Bono* Legal Services Advisory Committee and the Bankruptcy Diversity Task Force. She has lectured extensively for ABI, the Boston Bar Association, Massachusetts Continuing Legal Education, Massachusetts Bankers Association, Lorman Education Services and the National Conference of Bankruptcy Judges on small business and consumer bankruptcy issues.

Craig Zimmerman is the managing attorney for the Law Offices of Craig Zimmerman in Santa Ana, Calif., where his practice concentrates on consumer and small business bankruptcy and he represents clients in tax matters, FDCPA, TCPA and FCRA plaintiff actions. His firm also assists student loan borrowers with nonbankruptcy resolution of their student loans and prosecutes FDCPA actions against student loan debt collectors. Mr. Zimmerman was a debtor's attorney for most of his professional career and was previously in-house counsel for 3 subprime auto finance companies in southern California, during which time he oversaw the entire collection and bankruptcy units and was responsible for all litigation and nonstandard bankruptcy matters involving the companies. He is admitted to practice law in New York, New Jersey and California. Mr. Zimmerman earned his LL.M. in taxation from the University of San Diego.

POLL QUESTIONS

Poll Question #1: Has anyone been successful in obtaining discharge of student loan debt for undue hardship?
Results - 88% of respondents answered, NO, they have not been successful
- 12% of respondents answered, YES, they have been successful

Poll Question #2: Has anyone filed an adversary proceeding to discharge student loan debt for "undue hardship"?
Results - 71% of respondents answered, NO, they have not filed an adversary proceeding
- 29% of respondents answered, YES, they have filed an adversary proceeding