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Hearing Title: ***An Undue Hardship? Discharging Educational Debt in Bankruptcy***

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Testimony of

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Before the House Committee on the Judiciary  
Subcommittee on Commercial and Administrative Law  
Oversight Hearing Titled:  
*An Undue Hardship? Discharging Educational Debt in Bankruptcy*

September 23, 2009  
Washington, DC

Thank you for inviting me to testify today. I commend the Chairman and members of the Committee for recognizing the importance of how private student loans are treated in bankruptcy, which has never been addressed at a Congressional hearing before.

My name is Lauren Asher, and I am the president of the Institute for College Access & Success, a nonpartisan, nonprofit research and policy organization established in 2004. The Institute works to make higher education more available and affordable for people of all backgrounds, and our national Project on Student Debt focuses on trends in student loan borrowing and the implications for our families, economy, and society.

For the past few years, we have led a successful initiative to improve repayment options for federal student loans. This July, the new federal Income-Based Repayment (IBR) program, which was established by Congress in the College Cost Reduction and Access Act of 2007, went into effect. Based on a model we developed with support from both student and consumer advocates and the lending industry, IBR caps federal student payments at a manageable level based on the borrower's income and family size. It is available to borrowers with significant student loan debt relative to their income: for the most part, those who owe at least as much as they earn. In tough economic times like these, IBR can help responsible borrowers fulfill their obligations and avoid default without jeopardizing their ability to meet basic needs.

IBR is just one of the important borrower protections and repayment options that apply only to federal student loans, and not to the risky private student loans I am here to discuss today. Private student loans are mostly variable-rate consumer loan products offered by some banks and other lenders; they are not guaranteed by the federal government and have no relationship to the federal student loan programs.

## Student debt in context

Post-secondary education and training have become essential to the future of our nation as a whole, and to individual Americans who hope to enter or remain in the middle class. As family incomes, available grant aid, and state investments in higher education have failed to keep pace with college costs, students and families have increasingly turned to student loans to help bridge the growing affordability gap.

Two-thirds (67%) of all students who graduate from four-year colleges now have loans, and their average student loan debt is \$23,200. Graduates of public colleges and universities are not immune: more than three in five (62%) have loans, and their average debt is more than \$20,000. Graduates of for-profit colleges are the most likely to borrow and borrow the most: nearly all (96%) have loans, and their average debt is \$33,000.<sup>1</sup> These cumulative debt numbers, drawn from our analysis of the most recently available federal data, include both federal and private loans.<sup>2</sup>

While most undergraduate borrowers have federal student loans, a growing share has taken on private student loans in addition to, or instead of, safer federal loans. The proportion of all undergraduate students – in all sectors and all years of enrollment -- who took out a private student loan in 2007-08 was 14 percent, a dramatic increase from just four percent in 2003-04. As I will discuss further below, we have found that nearly two-thirds of undergraduates who borrowed private loans in 2007-08 had not exhausted their main federal borrowing option that year.

Looking just at those who graduate from four-year colleges, one third (33%) of all students who received a bachelor's degree in 2007-08 borrowed a private loan at some point before they graduated.<sup>3</sup> All of these numbers about student borrowing in 2007-08

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<sup>1</sup> From "Quick Facts about Student Debt." The Project on Student Debt. Available online at [http://projectonstudentdebt.org/files/pub/Debt\\_Facts\\_and\\_Sources.pdf](http://projectonstudentdebt.org/files/pub/Debt_Facts_and_Sources.pdf)

<sup>2</sup> The U.S. Department of Education's National Postsecondary Student Aid Study (NPSAS) is a comprehensive nationwide survey conducted every four years, most recently in academic year 2007-08. The data it collects on private student loans refers only to bank- and lender-originated loans, not all non-federal loans. NPSAS is the only nationally representative, publicly available source of information on private loan borrowing. Unlike the NPSAS data related to federal loans and other aid, which the federal government collects from multiple sources including colleges and lenders, the private loan data relies on student self-reports. Even when the same private lender, such as Sallie Mae, makes both private and federal student loans, it is only required to report data on the terms and repayment status of its *federal* loans to the Department of Education. Colleges do not necessarily know when students take out private loans or collect information about the private loans they do know about. The limitations of available data on private loans mean they can only be used for aggregate estimates. They do not, for instance, shed light on important issues such as private loan borrowing patterns at specific colleges, or allow mandated entrance or exit counseling for federal loans to provide borrowers with information about their total student loan debt.

<sup>3</sup> Baum, Sandy and Patricia Steele. *Policy Brief: How Much Are College Students Borrowing?* The College Board. August 2009. <http://professional.collegeboard.com/rofdownloads/cb-policy-brief-college-stu-borrowing-aug-2009.pdf>

exclude students who are not U.S. citizens or permanent residents and therefore ineligible for federal loans.<sup>4</sup>

### **Private student loans: more like credit cards than financial aid**

Private student loans, sometimes called “alternative” student loans, are offered by a variety of banks and other lenders, and they can generate huge profits through high variable rates and fees. Some lenders that offer private loans also offer federal loans through the Federal Family Education Loan Program, which subsidizes private lenders to make loans on the government’s terms and guarantees these loans against default. For example, Sallie Mae offers both federal Stafford loans and private “Smart Option” loans, both of which may appear on a student’s financial aid award letter with the Sallie Mae brand. Such dual offerings can leave students, parents, and even sophisticated finance reporters confused about the difference. Many wrongly assume that the term “student loan” itself designates a safe form of financing.

*Federal student loans* are designed to help ensure broad access to affordable financing for higher education and training, and they 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 federal tax dollars. Examples include the new Income-Based Repayment plan described above, deferments during periods of unemployment and some types of public service, and the right to cancel outstanding debt if a borrower dies, is severely disabled, or attends a school that shuts down before they can finish their degree. Federal loan terms and conditions are set by Congress, and they 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 ways to pay for a college education. They are not financial aid any more than a credit card is when used to pay for textbooks or tuition. Because of the high risks and costs associated with private loans, experts agree that students should always exhaust their federal loan options before even considering a private student loan

Private 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

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<sup>4</sup> From “Private Loans: Facts and Trends.” The Project on Student Debt. Available online at [http://projectonstudentdebt.org/files/pub/private\\_loan\\_facts\\_trends\\_09.pdf](http://projectonstudentdebt.org/files/pub/private_loan_facts_trends_09.pdf); Steele, Patricia and Sandy Baum. “How much are college students borrowing?” College Board Policy Brief. Available online at <http://professionals.collegeboard.com/profdownload/cb-policy-brief-college-stu-borrowing-aug-2009.pdf>

authority to increase borrower costs, such as raising interest rates in response to late payments.<sup>5</sup>

Because private loans do not carry the kinds of consumer protections that are guaranteed with federal loans, private loan borrowers are at the mercy of their lenders if they have trouble keeping up with punitively high payments, regardless of the reason. Even when lenders opt to offer a short-term forbearance, during which interest continues to accrue, lenders may charge borrowers additional fees for this costly form of temporary relief. Private loans are rarely cancelled even in cases of death or severe disability.<sup>6</sup> 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<sup>7</sup> or if you, “[i]n the lender’s judgment, experience a significant lessening of your ability to repay the Loan[.]”<sup>8</sup>

### **Private loans and bankruptcy: a double standard for consumer debt**

Despite their similarities to credit cards and other consumer debt, private loans are treated very differently under current bankruptcy law. Credit card debt and most other types of debt qualify for discharge when the borrower is approved for bankruptcy. In contrast, private student loans are treated like back taxes, child support, federal student loans and criminal fines, making them nearly impossible to discharge. Despite having already declared bankruptcy, consumers with private student loans must then initiate a separate legal proceeding, in which they have to prove to a judge that repayment of their private student loan debt would constitute an “undue hardship.” As other witnesses will discuss in more detail, without a high-priced attorney, this is virtually impossible to do, and even then the outcome depends more on which judge is assigned to the case than on the borrower’s situation.<sup>9</sup>

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<sup>5</sup> “2009 SLA Private Loan Series: Miss A Payment On Your Private Student Loan, You Could See Your Interest Rate Rise.” Student Lending Analytics blog. April 21, 2009. Available online at [http://studentlendinganalytics.typepad.com/student\\_lending\\_analytics/2009/04/2009-sla-private-loan-series-miss-a-payment-on-your-private-student-loan-you-could-see-your-interest.html](http://studentlendinganalytics.typepad.com/student_lending_analytics/2009/04/2009-sla-private-loan-series-miss-a-payment-on-your-private-student-loan-you-could-see-your-interest.html)

<sup>6</sup> Loonin, Deanne and Cohen, A. *Paying the Price: The High Cost of Private Student Loans and the Dangers for Student Borrowers*. National Consumer Law Center. March 2008. [http://www.studentloanborrowerassistance.org/uploads/File/Report\\_PrivateLoans.pdf](http://www.studentloanborrowerassistance.org/uploads/File/Report_PrivateLoans.pdf)

<sup>7</sup> “2009 SLA Private Loan Series: The Promissory Note.” Student Lending Analytics blog. April 20, 2009. Available online at [http://studentlendinganalytics.typepad.com/student\\_lending\\_analytics/2009/04/2009-private-loan-series-the-promissory-note.html](http://studentlendinganalytics.typepad.com/student_lending_analytics/2009/04/2009-private-loan-series-the-promissory-note.html)

<sup>8</sup> From the Student Loan Borrower Assistance webpage on “Default and Delinquency.” Available online at <http://www.studentloanborrowerassistance.org/default-and-delinquency/#private>

<sup>9</sup> Pardo, Rafael I. and Lacey, Michelle R., “Undue Hardship in the Bankruptcy Courts: An Empirical Assessment of the Discharge of Educational Debt.” *University of Cincinnati Law Review*, Vol. 74, No. 2, Winter 2005, pg. 7; Tulane Public Law Research Paper No. 05-06. Available at SSRN: <http://ssrn.com/abstract=706761>. See also Pardo and Lacey, “The Real Student-Loan Scandal: Undue Hardship Discharge Litigation” (October 24, 2008). *American Bankruptcy Law Journal*, Vol. 83, No. 1,

It is inappropriate and unfair both to borrowers and their other creditors to treat private student loans so differently from other comparable types of debt. The result is that private loan borrowers in dire financial straits can be condemned to a lifetime of collection agency harassment and ruined credit ratings simply because of the type of financing they used to help cover college costs. While many financial advisors will tell you that student loans are safer than credit cards, this is not necessarily the case for private student loans. At least if you put your tuition on a credit card, it would be dischargeable in bankruptcy should you ever reach unfortunate point of needing such relief.

It is important to note that personal bankruptcy is a very painful and costly process that people rarely undertake unless they have exhausted every other option. In 2005, the Bankruptcy Abuse Prevention and Consumer Protection Act made it much harder to qualify for personal bankruptcy

The 2005 law also made private student loans just as hard to discharge as federal student loans, despite the many important differences noted above. There are reasonable arguments for making federal loans at least somewhat harder to discharge than general consumer debt, if not necessarily as hard as criminal fines. For example, 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 federally guaranteed and are not required to provide such borrower protections or affordable payment options.

The high, unpredictable costs and inflexible repayment terms of private student loans can increase borrowers' risk of falling behind on mortgage payments or other kinds of debt, or going without health coverage and other necessities, just to keep up with their private loans. Such choices can lead to insolvency and even to bankruptcy, where at least some other debts could be discharged. Giving private student loan creditors preferential treatment in bankruptcy also puts other legitimate creditors at a significant disadvantage.

Shielding private loans from bankruptcy means that unaffordable repayment demands can essentially extend forever, leaving even the most destitute borrowers with no way out. This may make lenders less cautious about issuing high-cost loans to people who may not be able to afford them, including students at schools with low completion and job placement rates. For example, Sallie Mae dramatically increased its "non-traditional" or subprime lending to students at such schools in the years immediately following the 2005 bankruptcy law. Sallie stopped making these loans in 2008 because

of high default rates, which continue to rise for those students who were saddled with these unaffordable loans.<sup>10</sup>

Ironically, private loan creditors remain fully eligible for the bankruptcy protection that their borrowers are now denied. Bankruptcy helps failed businesses discharge outstanding debt and make a fresh start regardless of the nature or merits of their product or business model, or the types of debt they carry.

Last year, The Education Resources Institute (TERI) declared bankruptcy with tens of millions of dollars in outstanding debt. TERI guaranteed private student loans for First Marblehead Corporation, which was a major player in the private loan market and a strong advocate for making private loan debt non-dischargeable for borrowers. First Marblehead rode the wave of securitizations that led to the current credit crunch, packaging private student loans from other lenders and selling them as investments. When these loans experienced higher than expected default rates, TERI went bankrupt and First Marblehead's stock tumbled. Apparently, bankruptcy has enabled TERI to reorganize, and reports of its impending recovery buoyed First Marblehead's stock last month.<sup>11</sup> Meanwhile, TERI's website includes this reminder for private loan borrowers:

“The bankruptcy laws provide that, unlike other commercial debt, a loan guaranteed by TERI can not be discharged or forgiven in a bankruptcy proceeding unless the borrower proves that repayment of the loan will cause him/her undue hardship.”<sup>12</sup>

Also in 2008, Education Finance Partners, which specialized in private student loans, declared bankruptcy and closed its doors. It no longer has a website. In 2009, My Rich Uncle, another private loan company, declared bankruptcy.

### **Private loan market trends: up, then down, but definitely not out**

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<sup>10</sup> Sallie Mae reported that its “non-traditional” loan portfolio grew from \$3.7 billion at the end of 2006 to \$5.1 billion at the end of 2008, when it ceased originating new non-traditional loans because of high default rates, which available reports suggest may be nearly 50 percent this year. Sallie Mae defines these loans as “education loans made to certain borrowers that have or are expected to have a high default rate as a result of a number of factors, including having a lower tier credit rating, low program completion and graduation rates or, where the borrower is expected to graduate, a low expected income relative to the borrower’s cost of attendance.” From Sallie Mae’s quarterly report to the Securities and Exchange Commission, Form 10-Q, for the quarter ending June 30, 2009.  
[http://www.salliemae.com/NR/rdonlyres/98EB09F8-712E-41E5-B14B-B694791574F9/11349/2QTR200910QBOW75039BOW006\\_BITS\\_N\\_1517.pdf](http://www.salliemae.com/NR/rdonlyres/98EB09F8-712E-41E5-B14B-B694791574F9/11349/2QTR200910QBOW75039BOW006_BITS_N_1517.pdf)

<sup>11</sup> Sposito, Sean. “Heavy trading of First Marblehead draws attention.” Boston Globe. August 11, 2009. Available online at [http://www.boston.com/business/articles/2009/08/11/first\\_marblehead\\_declines\\_to\\_comment\\_on\\_unusual\\_market\\_activity/](http://www.boston.com/business/articles/2009/08/11/first_marblehead_declines_to_comment_on_unusual_market_activity/)

<sup>12</sup> From TERI’s website, page entitled “TERI – Loan Center – Students & Parents – Managing Education Debt.” Available online at <http://www.teri.org/loan-center/students-parents/managing-education-debt.asp>

Over the past decade, the private student loan market expanded dramatically along with the overall credit market, fueled by easy access to capital. As with subprime mortgages, lenders marketed private loans very aggressively and financed them primarily through securitization, maximizing short-term profits regardless of borrowers' actual ability to repay. There were no regulations to limit the dangers of private loans or to restrict the way they targeted young people with no borrowing experience. Prospective borrowers were not even entitled to clear information about actual terms and costs that would enable them to shop around before signing a promissory note. Private student loans remain largely unregulated, Congress included some basic disclosure requirements in the HEOA will go into effect early next year.

Private student loan volume began mounting well before the change in bankruptcy law: it increased eight-fold between 1997 and 2005, and it peaked at \$19 billion in academic year 2006-07.<sup>13</sup> Student Lending Analytics, which monitors industry trends, projects that volume in 2009 will be \$10-12 billion.<sup>14</sup> This drop parallels changes in the larger economy due to the credit crunch, which hit the private loan industry hard in the fall of 2008. While quite a few lenders left the market and private loans are now more likely to require a co-signer and a higher credit score than in recent years, private student loans are still available. Sallie Mae continues to make a third of its profits from private loans, and they along with Chase, Citibank and other major lenders offer and actively promote their private loan products.<sup>15</sup> As these lenders work to expand their market share, credit unions have entered the field and seek to position themselves as a source for more affordable private loans.<sup>16</sup>

In a particularly disturbing development, some large, for-profit colleges have begun making a lot of their own private loans directly to high-risk students.<sup>17</sup> For example, in a recent call with investors and analysts, Corinthian Colleges, Inc. said it plans to make

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<sup>13</sup> From "Trends in Student Aid." College Board Trends in Higher Education Series. Available online at [http://www.collegeboard.com/html/costs/aid/4\\_1\\_loans.html](http://www.collegeboard.com/html/costs/aid/4_1_loans.html)

<sup>14</sup> Ranzetta, Tim. HESC Symposium: Unlocking the Mysteries of Private Student Loans. Student Lending Analytics. September 2009. Powerpoint presentation available at [http://studentlendinganalytics.typepad.com/student\\_lending\\_analytics/2009/09/hesc-symposium-sla-presentation-on-private-student-loans.html](http://studentlendinganalytics.typepad.com/student_lending_analytics/2009/09/hesc-symposium-sla-presentation-on-private-student-loans.html)

<sup>15</sup> Saha-Bubna, Aparajita. Dow Jones Newswires. "Sallie Mae: Balance Sheet To Shrink As FFELP Loans Run Off." September 21, 2009. <http://www.nasdaq.com/aspx/stock-market-news-story.aspx?storyid=200909161017dowjonesdjonline000490&title=sallie-maebalance-sheet-to-shrink-as-ffelp-loans-run-off>

<sup>16</sup> See the Credit Union Student Choice web site at <http://www.studentchoice.org/> for press releases and marketing content, such as, "Unlike for-profit lenders, credit unions exist only to serve the best interests of their members-not to maximize profit for shareholders. This allows credit unions to offer lower loan rates and fees than other, more traditional "private" lenders."

<sup>17</sup> Pope, Justin. "For-Profit Colleges' Increased Lending Prompts Concerns." The Associated Press. August 15, 2009. Available online at [http://www.usatoday.com/news/education/2009-08-15-profit-college-lending\\_N.htm](http://www.usatoday.com/news/education/2009-08-15-profit-college-lending_N.htm). Also see "Corinthian Colleges, Inc. F4Q09 (Qtr End 06/30/09) Earnings Call Transcript" at <http://seekingalpha.com/article/158257-corinthian-colleges-inc-f4q09-qtr-end-06-30-09-earnings-call-transcript?source=bnnet>.

\$130 million of such loans in the current fiscal year, on top of \$120 million last fiscal year. They fully expect a shocking 56 to 58 percent of the borrowers to default. Yet they consider these loans good investments because they will increase enrollment and with it a profitable flow of federal grant and loan dollars that outweighs the planned writeoffs. Corinthian owns more than 80 colleges across the U.S. through its Everest brands.<sup>18</sup> According to the Associated Press, ITT Education Services, Inc. also expects to make \$75 million in loans directly to its students this calendar year, and Career Education Corp. expects to reach \$50 million.<sup>19</sup>

These are attempts to get around market corrections that have appropriately reduced access to subprime private loans for very high risk borrowers, and to justify prices for for-profit education and training programs that may exceed federal aid limits. As mentioned above, Sallie Mae has stopped lending to these types of schools because of similarly high default rates and other questionable practices. But whether the source is their own school or an outside lender, the students who are sold private loans they cannot afford are stuck with them even in bankruptcy, while the lenders are free to move on.

### **Who ends up with private student loans, and why**

Nearly three million undergraduate students ended up borrowing a private student loan in 2007-08, representing 14 percent of all undergraduates. Fully one third (33%) of all students receiving a bachelor's degree in 2007-08 borrowed a private loan at some point before they graduated. What else do we know about these borrowers?

- The odds of taking a private loan are highest at for-profit colleges, where 42 percent used a private loan in 2008-08. Next come private nonprofit four-year schools at 25 percent, public four-year schools at 14 percent, and community colleges at four percent.<sup>20</sup>
- The majority of undergraduate private loan borrowers attend lower priced schools. Almost two thirds (63%) of undergraduates with private loans were at schools with tuition and fees of \$10,000 or less.
- More than half (56%) of undergraduates with private loans are dependents age 23 or younger, and they borrow on average 45 percent more than their older counterparts.
- Seventeen percent of African-American undergraduates borrowed a private student loan in 2007-08, making them the most likely to borrow among all racial and ethnic groups. Their rate of private loan borrowing also rose the most steeply, quadrupling from 2003-04 to 2007-08.

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<sup>18</sup> From Corinthian College's website. Available online at <http://www.cci.edu/brands/everest>

<sup>19</sup> Pope, Justin. *Ibid.*

<sup>20</sup> From "Private Loans: Facts and Trends." The Project on Student Debt. Available online at [http://projectonstudentdebt.org/files/pub/private\\_loan\\_facts\\_trends\\_09.pdf](http://projectonstudentdebt.org/files/pub/private_loan_facts_trends_09.pdf)

- Nearly two thirds (64%) of all the undergraduates who took a private loan in 2007-08 borrowed less than they could have in federal Stafford loans. Of these students:
  - o More than one quarter (26%) had not used any Stafford loans that year, including 14 percent who had not filled out the Free Application for Federal Student Aid (FAFSA).
  - o More than one third (38%) had a Stafford loan, but for less than the maximum amount.

Students and families should be able to count on their college financial aid office to provide impartial advice about loans and lenders, and many of them can. However, over the past few years, federal, state and independent investigations have exposed numerous conflicts of interest between student loan companies and universities or their employees, raising questions about the integrity of the advice they give students about loans. College officials received gifts, trips, stock options and other benefits from lenders, while some colleges agreed to recommend certain lenders in exchange for kickbacks on the loan proceeds. In other cases, lenders provided staffing or call centers for a campus, posing as college representatives while providing financial aid advice—including information about private loans—to students. Congress passed legislation in 2008 aimed at curbing such abuses, but that did nothing to help the unsuspecting students who were saddled with unnecessarily costly loans.

Here are some examples of how students have been steered towards private loans:

- Education Finance Partners, a private loan company, made an arrangement with the Pratt Institute in New York: it would give the college money for need-based grant aid if Pratt students took out at least \$1 million in the company’s high-interest private loans.<sup>21</sup> Pratt cancelled the deal after two years, Education Finance Partners declared bankruptcy late last year, but the students who borrowed unnecessarily costly loans at the college’s recommendation do not have these options.
- An investigation by Iowa’s attorney general found that Iowa Student Loan Liquidity Corp. (ISL), a non-profit student loan company, gave kickbacks to colleges for steering students to ISL’s private loans and falsely advertised its private loans as the ‘lowest cost’ options available.<sup>22</sup> While ISL engaged in these practices, Iowa’s average student loan debt became the highest in the country.<sup>23</sup>

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<sup>21</sup> Glater, Jonathan. “New York Art College Canceled Deal with Lender After Learning of High Interest Rates.” *New York Times*. May 1, 2007. Available online at [http://www.nytimes.com/2007/05/01/us/01loans.html?\\_r=2&ref=education](http://www.nytimes.com/2007/05/01/us/01loans.html?_r=2&ref=education)

<sup>22</sup> From “Iowa Finds Lender’s Practices Hurt by Student Borrowers,” *Inside Higher Ed*. Available online at <http://www.insidehighered.com/news/2008/10/27/iowa>

<sup>23</sup> From “Student Debt and the Class of 2007.” The Project on Student Debt. Available online at <http://projectonstudentdebt.org/files/pub/classof2007.pdf>

- Silver State Helicopter ran unlicensed and unaccredited for-profit flight schools that charged up to \$70,000 in tuition. The company directly facilitated large private loans for thousands of students over nine years, some of whom were suing the school for fraud when it went bankrupt in 2008. The school collected all the loan money up front, yet Silver State had less than \$50,000 in assets and \$10 million in debt when it abruptly shut down.<sup>24</sup>
- As discussed above, some for-profit colleges are aggressively expanding their own private lending to students who are at very high risk of default. Pushing these students to take on private loan debt they cannot repay can be devastating for the students in the long run, but quite profitable for the school/lender.
- Last year we found that nearly a quarter of all public two-year colleges had opted out of the federal loan program, which prevented any of their students from using federal student loans. Nearly a million students attend these colleges, and they are disproportionately students of color. While many of these colleges believe they are acting in students' best interest by discouraging them from borrowing, a few openly encourage their students to borrow private loans by referring them to lenders. While there have been no allegations of conflicts of interest, and private loan usage at community college is still low, community college students with private loans are less likely to have maximized their federal loans than students in other sectors.

In contrast, some colleges go out of their way to help students avoid or minimize private loans and maximize federal loans and other aid instead. Both public and private colleges, such as Barnard College, Colorado State University, Loyola in New Orleans, and Northern Michigan University, have policies requiring counseling or warning students about the risks and alternatives when they learn that a student has applied for a private loan.<sup>25</sup> This has led to measurable reductions in private loan usage. For example:

- In 2005-06, 98 students at Barnard College, a private nonprofit college in New York City (2,400 students), took out a total of \$1,559,385 in private loans. In 2006-07 Barnard implemented a new policy that withheld certification until private loan applicants had spoken with a Barnard financial aid officer. This change resulted in nearly 60 percent of private loan applicants choosing to not

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<sup>24</sup> Friess, Steve. "Helicopter School Closes, Leaving Students in Lurch." New York Times. February 13, 2008. Available online at <http://www.nytimes.com/2008/02/13/us/13vegas.html>

<sup>25</sup> The opportunity arises when students apply for "certified" private loans. Lenders will not issue the loan until the school confirms the student's enrollment, cost of attendance, and aid received. Students may also get "uncertified" private student loans, which require no contact between the lender and the school. In those cases, the school may never learn that the student applied for a private student loan.

take out a private loan, and it reduced the total amount of private loans by almost 75 percent, or approximately \$1.1 million.<sup>26</sup>

- At Colorado State University, a public institution in Fort Collins (24,000 students), financial aid officers contact approximately 20 percent of private loan applicants because they either have not filled out their FAFSA or have maximized their federal student loans. Half of the contacted applicants opt to pursue their federal borrowing options first.<sup>27</sup>

## **Conclusion**

Until 2005, bankruptcy law appropriately treated private student loans like credit cards and other comparable forms of consumer debt. Since then, punitive treatment in bankruptcy, combined with the continued lack of access to affordable repayment plans or other consumer protections, has left private loan borrowers with virtually no options for managing this type of high-risk, high-cost consumer debt. Millions of Americans who sought to further their education should not face higher hurdles in bankruptcy than the lenders who saddled them with these unaffordable loans.

Thank you again for the opportunity to testify today. I would be glad to answer any questions.

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<sup>26</sup> From "Bucking the Tide on Private Loans," *Inside Higher Ed*. Available online at: <http://www.insidehighered.com/news/2007/07/16/barnard>

<sup>27</sup> From "Colorado State Does Student Loans Right," *HigherEdWatch.org*. Available online at: [http://www.newamerica.net/blogs/education\\_policy/2007-08/colorado\\_state](http://www.newamerica.net/blogs/education_policy/2007-08/colorado_state)