

A CALL FOR STUDENT LOAN BANKRUPTCY REFORM

Virtually everyone agrees the status quo of higher education in the U.S. is unsustainable. Tuition has skyrocketed, causing students to take on loans they can't pay back after graduation because they can't find jobs. While politicians haggle over whether to *raise* interest rates, the student loan bubble begins to look more and more like the gestation period of the sub-prime mortgage crisis that impacted the entire world. Something clearly has to be done.

One possible solution is to reform the laws governing student loan bankruptcy. What follows is a primer on the state of student loans and the reform movement today. Spoiler alert: the outlook is not good.

Where the debt stands:

- [Total student debt now totals over \\$1 trillion](#). That's trillion, with a T. That's more than any other type of consumer debt, including for credit cards and cars. Of that amount, \$150 billion belongs to 2.9 million students in debt to private lenders. The other 85% is footed by the government.
- **The default rate is steadily rising.** A clear sign students are drowning in debt is the number considered in default (generally, nine months behind in payment). A recent report by the Consumer Financial Protection Bureau (CFPB) and the Department of Education found [private loan default](#) is greater than \$8 billion, spread out among 850,000 unique loans. For federal loans, the average [federal loan default rate by state](#) is 7.85%, which would put the overall default amount around \$66 billion. A full 27% more of all student debtors are delinquent (behind by less than nine months) on at least one loan.
- [Nearly 30% of student debt belongs to students who dropped out of school](#). Students without degrees default four times as often as college graduates. By dropping out, they rob themselves of \$3.8 billion in lifetime wages as a group, a hefty chunk of change that could be used to pay off loans.

Where the law stands:

- [Since 1998, to discharge federal student loans via bankruptcy has required proving "undue hardship."](#) In 1987, a federal circuit court set the strict standard for absolving student loans through bankruptcy: prove you can't maintain a "minimal" standard of living if you continue to pay; prove your living situation will not improve over most of the loan's life; and prove you've made real efforts to repay the loan. The next year, Congress adopted the "undue hardship" rule as the law for federal loans.
- [In 2005, the "undue hardship" clause was extended to private student loans.](#) In a secret meeting, this clause was slipped into the Bankruptcy Abuse Prevention and Consumer Protection Act as a provision known innocuously as Section 523(a)(8).

People and groups supporting reform:

- [Consumer Financial Protection Bureau](#): The CFPB (and by extension, President Obama), in truly political fashion, supports reexamining the issue of student bankruptcy law. Director Richard Cordray has admitted student loans are "nearly impossible to be discharged" but will only go so far as to say, "It would be prudent to consider whether [Congressmen] wish to modify the code."
- [Sallie Mae](#): The president of education lender SLM Corp. (aka Sallie Mae) said in July that the company is in favor of bankruptcy reform for both federal and private loans, as long as a period of "good-faith payments" is required.
- [Sen. Dick Durbin](#): This Democrat from Illinois is one of the loudest voices calling for bankruptcy reform in the country. He has introduced bills that require private lenders to be fully transparent with students when giving them a loan, as he says "most students just sign" without knowing what they're getting into. He also wants an end to the way private student loans are treated differently than regular loans when it comes to bankruptcy, calling the situation "a new debtor's prison." Unfortunately, Durbin said recently [the bills are "going nowhere."](#)

- [Rep. Steve Cohen](#): Last year, Memphis Democratic Congressman Cohen sponsored the Private Student Loan Bankruptcy Fairness Act of 2011. If passed, the bill would strike Section 523(a)(8) and return private loans to the way they were treated before 2005. But the bill seems to be currently in limbo as Cohen tries to gain [co-sponsors in the House](#); he currently has 45. All signs indicate the soonest the bill could advance beyond committee is 2013, if and when the Democratic Party takes control of the House of Representatives. People and groups against reform:
- [The banking industry](#): Of course, after spending \$100 million to get the 2005 law passed, the banking industry is not anxious to see its investment squandered. “The bankruptcy system would be opened to abuse,” say the American Bankers Association and the Financial Services Roundtable. Banks like [Wells Fargo](#) and other critics of reform also warn that interest rates and bank fees will go up in response to the added risk lenders would be taking on as a result of giving students the ability to declare bankruptcy.
- [The GOP](#): As we’ve seen, with its control over the House, the Grand Old Party is effectively blocking student loan bankruptcy reform. But in a weird way, the Republican Party actually does want to solve students’ federal loan burden, but not by making it easier to declare bankruptcy: by [getting rid of federal loans altogether](#). While saying on one hand lenders need to be required to be more transparent, the GOP also claims in its platform that the government should be a guarantor for private lenders. In other words, their concern is for the protection of banks, not borrowers.
- [Mitt Romney](#): The presidential candidate has not specifically commented on the bankruptcy issue, but he has told students not to expect the government to forgive their college loans. But he isn’t leaving you with nothing, kids: he is happy to give you advice. Namely, shop around for a cheap college and borrow from your parents.

Much like with the sub-prime mortgage crisis, it appears politicians and bankers would rather argue after the fact over whose fault the disaster was than avert disaster while there’s still time. Nevertheless, for good or bad, student loan reforms are almost certainly coming on the heels of the November elections. Whether bankruptcy regulations will be among those reforms, students will just have to wait and see.

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