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Dem Urges New Student Loan Discharge Rights

By Janet Lorin on March 20, 2012

Students who take out loans from private lenders to finance their education should have the same right to discharge their debt in bankruptcy that other borrowers enjoy, Illinois Senator Dick Durbin said today.

"While the overall growth in student indebtedness is troubling, the most pressing concern is private student loans," Durbin, the No. 2 Senate Democrat, said in prepared remarks at a Senate judiciary subcommittee hearing. "These private student loans are a far riskier way to pay for an education than federal loans."

Outstanding student-loan debt reached an estimated $867 billion in the fourth quarter, and is greater than total U.S. credit-card debt. The student debt includes private loans, which don't offer options as some government-backed loans when borrowers become financially distressed, including income-based repayment. Durbin introduced a bill in May to eliminate a 2005 provision that made privately issued student loans nondischargable in bankruptcy.

Five years after graduating from Harrington College of Design in Chicago, Danielle Jokela has yet to find a job as a designer and struggles to repay more than $98,000 in student loans.

"I'm asking you to create legislation that will empower us to overcome this burden, and prevent future students from falling into the same trap," Jokela said in prepared testimony for the hearing. She has a monthly debt payment of about $830, about 28 percent of her current income. Harrington is operated by for-profit college company Career Education Corp.

Sallie Mae

The largest private student lender is SLM Corp., (SLM) known as Sallie Mae, which made $2.7 billion in private education loans last year, up 19 percent from a year earlier, the company said in a statement in January. It expects to originate about $3.2 billion this year.

Sallie Mae’s portfolio of private student loans was about $36 billion, and loans to students at for-profit colleges account for about 10 percent, according to the Newark, Delaware- based company.

“Sallie Mae supports reform that would allow federal and private student loans to be dischargeable in bankruptcy for those who have made a good-faith effort to repay their student loans over a five-to-seven year period and still experience financial difficulty,” Patricia Nash Christel, a spokeswoman for the company, said in an e-mail.

‘Severe’ Treatment

Deanne Loonin, an attorney for the National Consumer Law Center, said harsh treatment of students in the bankruptcy system was built on the false premise that they are more likely to abuse the system.

“Current bankruptcy law treats students who face financial distress the same severe way as people who are trying to discharge child support debts, alimony, overdue taxes and criminal fines,” Loonin said in written testimony. “Yet there is no evidence and has never been any evidence to support this assumption.”

Congress has investigated high rates of default on student debt at for-profit colleges, where as much as 90 percent of revenue comes from government grants and loans. The U.S. Education Department released rules last year that may cut off government funding to schools where students struggle the most to repay their loans.

‘Unjust Transfer’

Reinstating the rule to let privately issued loans be dischargeable in bankruptcy would increase the cost for all student borrowers because interest rates would rise, said G. Marcus Cole, who teaches commercial and financial law and regulation at Stanford University near Palo Alto, California.

“If the goal is to relieve the debt burden upon student borrowers who have taken on student debt that did not result in higher productivity and earnings potential, removal of the exemption is a blunt instrument that is unlikely to address the root source of the problem, accomplishing instead a one-time, unjust transfer from innocent lenders who did nothing more than give money to people in the hopes of being repaid someday,” Cole said in written testimony.

The root issue is tuition inflation, and restoring the loan discharge rule may have “a very marginal impact” on the issue of student debt, said Neal McCluskey, associate director of the Cato Institute’s Center for Educational Freedom.

Higher Rates

"If lenders know that borrowers can escape repayment through bankruptcy, they would likely raise interest rates to account for that risk and lend to fewer people, discouraging use of such loans," McCluskey said in testimony. "However, students might be more apt to take such loans -- and pay still higher college prices -- if they think that they will be able to unload their debt without repaying it."

Senator Mike Enzi, the Wyoming Republican and ranking member of the Senate education committee, doesn't support discharging student loans, said Sarah Chu, a spokeswoman for Enzi.

Enzi would prefer the Senate committee address the rising cost of higher education rather than "a number of incomplete solutions," he said in an e-mailed statement.

"Recognizing that many Americans may encounter unexpected financial difficulties during the repayment of their student loans, Congress has already enacted a variety of protections to help student loan borrowers avoid default and protect their credit," Enzi said.

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