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*College Try*

## U.S. Gets Tough On Failure to Repay Student Loans

Education Department Wields  
Heavy Hand, Critics Say,  
In Some Hard-Luck Cases

No Breaks in Bankruptcy Court

By JOHN HECHINGER

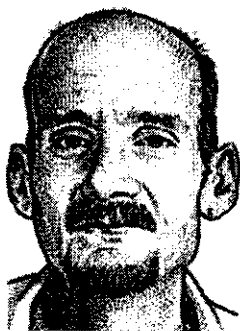
 Staff Reporter of THE WALL STREET JOURNAL  
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ROLAND, Okla. -- The bill collector called when Clay Stanley, gaunt and suffering from AIDS, lay bedridden in his apartment, back from the hospital after a bout with a viral infection.

It wasn't about a car or credit card. The call concerned a matter Mr. Stanley, who is 39 years old, says he had long forgotten: student loans he took out two decades before. The private collector, acting on behalf of the U.S. Department of Education, said Mr. Stanley must pay \$69 a month or the government would take a larger sum than that each month from his Social Security disability checks, Mr. Stanley recalls. "I didn't know what to do, so I said 'OK,' " he says.

Years after a political outcry over high levels of student-loan defaults, the Education Department has become one of the toughest debt collectors around. Over the past decade, it has won a steadily expanding arsenal to wield against former students who don't repay.

A 1998 change in federal law, for instance, made it extremely difficult for people to escape student loans through personal bankruptcy. The Education Department also can now seize parts of borrowers' paychecks, tax refunds and Social Security payments without a court order, a power that only the Internal Revenue Service, among federal agencies, regularly wields.



Access to a government database of the newly employed has enabled the department to make much more effective use of private collection companies. And it can go after even decades-old student loans, because there's no statute of limitations on them, unlike most consumer debt.

As a result, the Education Department collected \$5.7 billion in defaulted student loans in the fiscal year ended Sept. 30, more than twice as much as in 1998. For current loans that go into default, the department now projects it will ultimately retrieve every dollar of principal, plus almost 20% in fees

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and overdue interest, a prediction few private lenders would be bold enough to make.

The aggressive approach has sparked an outcry from some borrowers, consumer-advocacy lawyers and even some bankruptcy-court judges. They complain that the department runs roughshod over some former students who've suffered reversals of fortune. "Student-loan debt collectors have power that would make a mobster envious," says Elizabeth Warren, a Harvard Law School professor and bankruptcy specialist.

Some who favor a softer stance argue that student loans are a form of financial aid -- not quite the same as other consumer credit. They also note that the borrowers have, after all, been encouraged by the federal program to go into debt to attend college. And they say students are usually financially unsophisticated borrowers, lacking an understanding of how debts can pile up because of unpaid interest. So shouldn't they get more slack, the critics ask, than, say, credit-card spendthrifts?

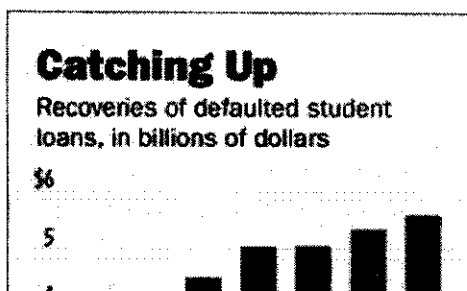
The Education Department responds that taxpayers, legislators and the many students who do repay their loans all expect it to pursue those who don't. It says the federal government, the state agencies that administer the program and the private lenders that primarily make the federally guaranteed loans all work with past-due borrowers. They offer counseling and a chance to refinance at today's low interest rates, says Terri Shaw, the Education Department's chief operating officer for student aid, who adds that there are plans that link the size of payments to incomes. "We're here to help," Ms. Shaw says.

#### Default Rate

The government's toughness traces back to the 1980s, when politicians became alarmed by high levels of student-loan defaults. Some waged a campaign against deadbeat doctors, lawyers and other professionals taking advantage of the government.

Today the default rate on recently made loans has dropped. It was 5.2% last year, down from 22% in 1990. And professionals such as doctors and lawyers are far from the worst offenders. Graduates of four-year or graduate programs at private universities default at a 3.1% rate, while students of trade schools and community colleges default at almost twice the 5.2% overall rate, according to Education Department data. Studies show that those most likely not to repay are students who, like Mr. Stanley, didn't complete their studies.

In the 1980s, Mr. Stanley took out a \$3,700 student loan to attend Garland County Community College in Hot Springs, Ark., then transferred to Henderson State University in Arkadelphia. He never graduated, figuring he needed to take a job to support himself. He worked as a clerk in a hospital, a toy-store manager, a bartender and a blackjack dealer, never earning more than \$7 an hour.



After Mr. Stanley learned 10 years ago he had the AIDS virus, he started living on disability checks from Social Security. Standing 6 feet 2 inches, he now weighs just 106 pounds and needs a rubber band to keep a ring from sliding off his thinned ring finger. He doesn't have a job and takes 16 pills a day to stay alive. To help make ends meet, he has a roommate in his apartment in Roland, Okla., near the Arkansas border.

Mr. Stanley says he hadn't heard anything about his student loan in six or seven years when he got a call in late 2003 from Pioneer Credit Recovery Inc. Pioneer is a unit of student-loan giant SLM Corp., commonly called Sallie Mae, and has a contract to collect for the Education Department. Mr. Stanley learned that unpaid interest and penalties had nearly doubled his balance to \$7,000.

He was getting \$696 a month in Social Security disability payments. He says a Pioneer agent challenged the \$225 a month he was paying on his 1999 Pontiac Grand Am, which he uses to drive to a clinic in Tulsa, Okla. "I told him you can take my car if you'll drive me to my doctor's appointments," Mr. Stanley says.

He says the agent told him he needed to start paying \$69 a month, or the government could withdraw \$189 from each monthly disability check. Mr. Stanley says he agreed to pay \$69 a month for six months. He supplied his bank-account number and the withdrawals began.

A spokesman for Pioneer's parent, Sallie Mae, says privacy laws don't permit discussing details of clients, but "we followed all appropriate laws, regulations and procedures in working with and counseling the borrower." Sallie Mae -- once federally chartered but now separate from the government -- buys and repackages loans for sale in the secondary market. It also now originates and services student loans, and its Pioneer unit collects under contract with the Education Department. Like all the student loans, the ones Sallie Mae makes are guaranteed by the federal government.

The Sallie Mae spokesman, Tom Joyce, notes that the government will cancel a student loan only if a doctor signs a form saying the borrower is "totally and permanently disabled." Mr. Stanley says his doctor wouldn't. Without such a signed form, Mr. Joyce says, Sallie Mae's collection unit offers options "to get the loan back on track," and "if that fails, we have no choice but to refer the case" to a state guarantee agency or to the Education Department.

Mr. Stanley says he got a letter this week saying the Education Department had directed the Treasury Department to make automatic deductions toward his delinquent loan from his Social Security disability check, which now is up to \$785 a month. The letter didn't say how much the deductions, to begin in March or later, will be. He says the letter did say that the government was permitted to take up to 15% of his check, provided the monthly benefit didn't fall below \$750.

Federally guaranteed student loans began with President Johnson's "Great Society" campaign. Now two-thirds of students at private four-year colleges have them, averaging \$17,000 at graduation, says the American Council on Education, which represents college and university presidents. Students who go on to private law, medical or other professional schools end up owing an average of almost \$74,000. The Education Department opened the program to higher-income families in 1992. Loans outstanding have tripled over the past decade to \$357 billion.

Though the U.S. government makes some of the loans directly, most are made by private lenders such as banks, with the government guaranteeing payment. The guarantees plus federal interest-rate subsidies let lenders offer low rates despite students' scant credit history. The rate on new student loans, set annually and tied to Treasury bills, is now 3.37%. Repayment generally begins six months after graduation. The repayment term is usually 10 years, but borrowers can choose a longer one.

If no payments are made for 270 days, loans are in default. Then state agencies -- which both administer the loans and offer lenders an initial guarantee -- will try to collect. If they can't, they

will kick the loans back to the Education Department. The department has a stable of collection firms it uses. Under federal law, the collectors are entitled to 20% of what they recover. Those fees are added to borrowers' loan balances.

Four years ago, the collectors started using a national directory of the newly employed compiled from employers' filings with state employment divisions. That has helped in tracking down defaulted student-loan debt, which now totals \$30 billion.

### An 'Undue Hardship'

In 1998, largely unnoticed, the federal law governing the loans was changed so borrowers could shed them in bankruptcy only by proving it was an "undue hardship" to repay. Student loans thus joined a rarified class of obligations, such as child support and restitution in criminal cases, that can almost never be shirked. It is a very hard test to meet, as cases such as Carol Ann Race's show.

In the 1980s, Ms. Race borrowed \$20,000 to study theology and philosophy at the University of St. Thomas in St. Paul, Minn., and another school. Now 42, she has five children, ages 4 through 11. Two are autistic.

Her husband earns \$18,000 a year as a nursing-home aide. The family of seven lives in Bertha, Minn., on \$28,000 a year, including government disability payments to the autistic children. Ms. Race says she made \$300 monthly payments on her student loan for 2½ years before she lost her job as a religious educator in a church in 1994.

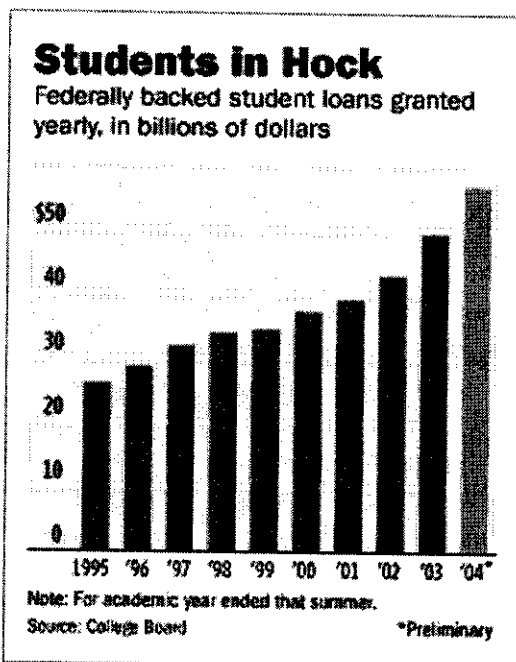
She filed for bankruptcy in hopes of getting the loans -- the family's only debt -- canceled. A year ago, U.S. Bankruptcy Court Judge Dennis O'Brien ruled against her. In an interview, the judge says he wanted to let her out of the loans but was sure he would be reversed on appeal. His opinion said that because of higher-court rulings, he couldn't cancel her student loans unless he found that repayment would "strip Race or her family of all that makes life worth living."

At the end of her case, Ms. Race owed \$34,000 at 7% interest. Pursued by two state agencies that made the initial guarantee on her loans, she has signed up for a repayment program with a 5.125% rate; the payments will be linked to family income. She says she will be paying the debt for decades, making it difficult to set aside money to care for her children.

"I always felt if I could get a judge to listen to me, it would be simply gone -- they would forgive the loan," Ms. Race says. "Anybody who has any heart at all could see that our circumstances weren't brought about by our actions or our foolishness."



Over the years, some bankruptcy judges have opposed the rule tightening. Bankruptcy Court Judge A. Jay Cristol, who presides in southern Florida, sees the policy as "way too harsh." The Education Department's Ms. Shaw says the government should make it tough to get out of student loans



because taxpayers have already given the borrowers a valuable asset, an education, and it isn't collateral that can be repossessed.

### **Tightened Treatment**

In the mid-1990s, a federal commission taking a broad look at the bankruptcy code said education-loan abuses cited by lawmakers were infrequent, "more perception than reality." The panel, mainly lawyers specializing in bankruptcy and related fields, recommended treating student loans like other consumer debts in bankruptcy.

But not long after, in 1998, Congress tightened the bankruptcy treatment of student loans. The change resulted from wrangling over an education bill, says Henry Sommer, editor in chief of *Collier on Bankruptcy*, a legal reference work. The Clinton administration was seeking a reduction in student-loan interest rates, a move lenders opposed. The administration agreed to provide a subsidy to cushion the rate cut for them. At the same time, the government changed the treatment of student loans in bankruptcy, which would mean smaller losses for the Education Department and taxpayers.

That leaves borrowers like Jonathan Gerhardt, 46, little choice but to pay. He is a cellist. The child of two classical musicians in Columbus, Ohio, he studied at the New England Conservatory of Music, performed with two city orchestras and finally won a spot as principal cellist at the Louisiana Philharmonic Orchestra in New Orleans. Despite climbing this high in his field, he was earning just \$20,000 a year three years ago, including pay for teaching cello at Tulane University. He buckled under his \$100,000 in student loans and filed for bankruptcy.

Lawyers for the Education Department and a guarantee agency that held some of the loans sought to make him pay. The opinion of a bankruptcy court in New Orleans says the lawyers told the court Mr. Gerhardt could trim his expenses, such as \$23.90 a month for Internet access and \$48.51 for a gym membership. They also suggested he get rid of his cat to save \$20 a month.

Bankruptcy Judge Jerry A. Brown, however, said Mr. Gerhardt had to work out to relieve back pain from playing the cello, and needed the Internet to look for extra work. "Expenses related to his cat are not luxuries, considering he is single and lives alone," the judge wrote. He ruled that repaying the loan would be an "undue hardship" and expunged it.

The Education Department appealed. A federal appellate court sided with the government. It suggested Mr. Gerhardt find a job as a music-store clerk.

Mr. Gerhardt says he is already working 60 hours a week, including rehearsals for the Louisiana Philharmonic, practicing and teaching. He recently moved into an apartment with a roommate, saving \$50 a month on rent. He says he stopped taking annual trips to Ohio to visit his 81-year-old mother, and doesn't believe he will ever be able to support a family or afford a house. Mr. Gerhardt says he is now paying \$200 a month toward his loan. The government wants \$900.

"I wish I had known it would be like this," he says. "I would have gone to a less-expensive graduate school. I will be paying for this for the rest of my life."

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