Testimony of

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Subcommittee on Commercial and Administrative Law

Hearing on the “Private Student Loan Bankruptcy Fairness Act of 2010”

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Thank you Chairman Cohen, Ranking Member Franks and the other distinguished members of the Subcommittee for the invitation to testify this morning. I commend the Chairman and members of the Subcommittee for continuing the work begun last September to better understand how making a seemingly simple change to the bankruptcy code might affect students as they seek the most affordable alternatives to financing their educations – a goal shared by all.

My name is John Hupalo. I am a Managing Director at Ramirez Capital Advisors, a group specializing in student loan finance at Samuel A. Ramirez and Co. I need to begin with the disclaimer that the views I express here today are my own personal opinions and do not represent the views of my employer or any other organization.

My experience with student loan programs began as a borrower in 1978. I am deeply indebted to the United States Congress for creating a student loan program that afforded first generation college aspirants like me an opportunity for educational advancement we may otherwise not have had. The programs were then, and remain today, essential to providing access to education for many Americans.

Although I did not initially plan for my professional career to be focused on helping others pay for college, it has. In 1987, after a stint here on the Hill and then obtaining my MBA, I began working with state agencies and other not-for-profit entities on ways to cost-effectively finance student loans made under the auspicies of both the federally guaranteed student loan program as well as loan programs that did not benefit from a federal guaranty or subsidy. These necessary programs are now known as private student loans because they were and are created with credit underwriting criteria akin to other consumer loans such as mortgages or credit cards or auto loans. I also helped for-profit student loan entities -- including The First Marblehead Corporation where I served as the Chief Financial Officer – to structure responsible private student loan programs.

The issues today, unlike 1978, are significantly more complicated as college costs have significantly outpaced inflation during that time, the amount of debt borrowers have procured is at record levels, the Congress has been engaged in a decades long debate over the most advantageous student loan delivery system and most recently the melt down of the global credit markets has wreaked havoc on traditional sources of education funding. We are all concerned that student access to education may be compromised as a result.

The fairly narrow, but important, question you consider today – whether to permit the discharge of private student loan debt in bankruptcy – is another in a long line of policy issues which in isolation appear fairly simple but are quite complex when considered along the broader spectrum of education lending policy. I understand the intended benefit of repealing non-dischargeability of private student loans, but I am concerned that it will be counter-productive to the country’s shared goal of making a college education more accessible to the greatest number of students possible.

Although I am not expert in the federal bankruptcy code, I do understand why non-dischargeability is a cornerstone to keeping private student loan interest rates as affordable as possible. Unlike other loans, student loans are generally made to very young borrowers who at the time of the borrowing have no job, no prospect of a job, no credit history and often no other assets. Furthermore, the loan products themselves are the most consumer friendly loans in the market place: the loan may be paid over a period of 10 – 30 years, most do not require any payments until a student separates from school – often many years after the loan was first made, there are no prepayment penalties for borrowers who wish to pay ahead of schedule, and there are opportunities for borrowers to stop making payments for a period of time even after the repayment period commences. The combination of this profile of borrower and product is very difficult for lenders to serve absent some other incentive to make these socially necessary loans: non-dischargeability is one such feature. This provision is also important to investors who purchase loans in the secondary market.

When lenders – be they (a) not-for-profit or state agency lenders, (b) for-profit financial institutions, schools or finance companies, or (c) the federal government – enter the competitive student loan market place, they share a few commonalities including the requirement that the loans make some amount of money for the lender. Admitedly, the nomenclature can be confusing. Even lenders with non-profit charters and public purpose missions need to offer economically responsible, profitable products to be viable. This is true for the federal government loan programs as well. In order to design such a product, the lender must assess the risk that a borrower will be unable to repay the loan in full – a common question for lenders across all asset classes: mortgages, home equity loans, credit cards, automobiles, boats and every other type of loan you can name. Private student lenders faced with the borrower profiles and required product set previously discussed create lower cost loans as a result of the value of non-dischargeability. There is no question that interest rates for all borrowers would have to increase in order to compensate for the increased risk of loss if borrowers had the option to routinely discharge private student loan debt.

Students are smart but relatively immature consumers of very expensive goods and services, like a college education. Some would undoubtedly seek to exploit the narrow question of today's discussion. With no assets to lose, an education in hand, why not discharge the loan without ever making a payment to the lender? I fear that borrowers just out of school would discount other risks and be saddled with unintended consequences potentially hampering their ability to buy furniture or a car or their first home on credit a few short years after the discharge. In the long run, discharging this debt would not be a net benefit to these borrowers.

Having said this, few would disagree that college costs have risen too quickly, and too many students have taken too much credit over too long a period of time. These issues are being addressed separately by the market place and other Committees of this Congress. And certainly there are borrowers who face terrible economic hardships resulting from horrific events beyond their control. Their plight should properly be addressed with existing law, the "undue hardship" exemption. Judges may benefit from a clearer explanation of Congressional intent in this area or more specific criteria for implementing this important protection so that those in need receive proper relief without raising costs or increasing risks for the super majority of other borrowers.

I hope this perspective is useful to you. There are two other specific aspects of the proposal on which I would like to make a brief comment. First, the bill currently removes non-dischargeability protection for loans already consummated. Retroactively re-writing a contract strikes me as simply wrong. How could any transaction in our consumer society be taken seriously if material terms could be retroactively changed by one of the parties or the United States Congress? As I noted earlier, lenders initially priced loans based on the perceived risk and mitigants including the contract's non-dischargeability. Furthermore, investors around the world who previously purchased loans in the secondary market would no doubt be injured by retroactively negating the non-discharge provisions. Preserving the sanctity of this contract law should be paramount. Lenders and investors join borrowers in relying on the Courts to judge the fairness of contracts and know that the current bankruptcy code permits a discharge of education loans resulting from undue hardship. As I suggested earlier, providing more detailed undue hardship criteria for the Courts could provide the necessary relief rather than unfairly taking a current contract right.

Second, the legislation calls for separate treatment of dischargeability for for-profit and not-for-profit entities. Maintaining the 2005 legislation's goal of identical treatment of dischargeability for private student loans – regardless of the corporate structure of the lender -- continues to make sense. Creating classes of lenders is inequitable and will lead to market place confusion. Students already face a dizzying array of choices when selecting a loan product – adding the consideration of different bankruptcy options will only further confuse students. All private student loans should be non-dischargeable.

In conclusion, I again commend the Subcommittee for undertaking this hearing. Although the proposed legislation is no doubt well intended, I am concerned that it could increase the cost of all private student loans, reduce access for some borrowers and increase the risk of unintended consequences for those who successfully discharge their loans. If the Subcommittee's goal is to protect the most distressed borrowers then I believe that clarifying the "undue hardship" standard – a current consumer protection lynchpin for student loan borrowers— is far preferable to undoing the 2005 legislation.

Thank you for considering my remarks.

I look forward to your questions.