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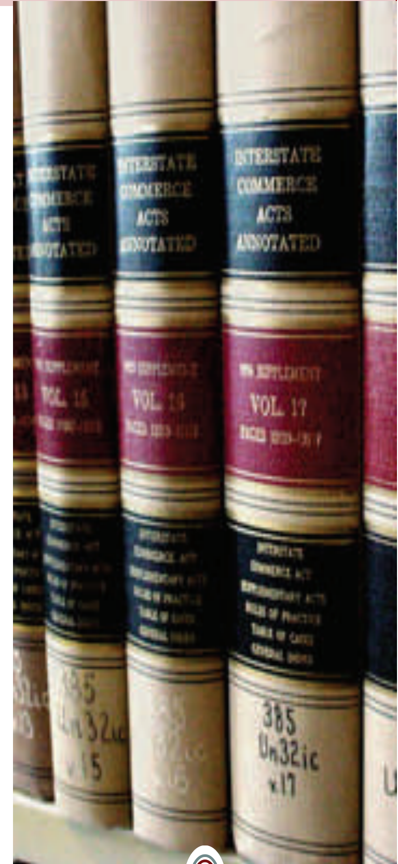
Advocating Justice for the Consumer



This is the fifth issue of the Statewide Consumer Law Project ("SCLP") Newsletter. As with prior issues, its purpose is to spotlight new and existing consumer issues and SCLP activities.

Comments and suggestions are appreciated and may be directed to Brad Gelder, Attorney, SCLP, at bgelder@clsaz.org

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INTRODUCTION

This issue of the Statewide Consumer Law Project (SCLP) Newsletter is devoted to a discussion of federally guaranteed student loans and questions frequently asked by low income borrowers. Most often, consumer borrowers want to know if they can (1) eliminate/discharge (2) postpone repayment of or (3) reduce repayment obligations. Also of note is the newly passed Federal Garnishment Rule, which is summarized at the end of the newsletter.

DISCHARGE

Bankruptcy

Eliminating the loan obligation entirely constitutes a discharge of the debt. Very infrequently, this can be achieved through a bankruptcy but the test is stringent. The borrower/debtor must establish an inability to maintain a minimal living standard for himself or herself and his or her dependents based on his or her current income and expenses AND that this state of affairs is likely to continue for a significant portion of the repayment period. This is very difficult to establish in practice.

Administrative

The three most frequent types of federally guaranteed loans are issued under the Federal Family Education Loan Program (FFEL's), the Federal Direct Loan Program (Direct Loans) and under the Perkins loan programs.

These loans can be statutorily discharged for several reasons including:

1. ***SCHOOL CLOSURE.*** The school closed before the student was able to complete the program.

2. ***FALSE CERTIFICATION*****.** Included among the categories:
    a. School falsely certified a non-high school graduates ability to benefit from the program;
    b. School enrolled a student unable to meet the minimum state requirements for the job for which the student was being trained;
    c. School forged or altered a loan note or check endorsement;
    d. The borrower was a victim of identity theft.

3. ***UNPAID REFUNDS.*** School failed to refund monies due the student.

4. ***DISABILITY.***

5. ***DEATH.***

POSTPONEMENT OF REPAYMENT OBLIGATION

This is known as a deferment. A deferment will not only postpone or defer the repayment obligation but, in the case of *subsidized* loans, the borrower's interest obligations are paid by the federal government during the deferment period.

REQUIREMENTS. Borrowers can not be in default status (more than 270 days delinquent). If they are, eligibility can sometimes be regained through loan consolidation or rehabilitation (discussed below).

Grounds for Deferment.

1. Previous qualification under another federal loan program;

2. Receipt of federal or state public assistance benefits;

3. Peace Corps participation;

4. Income Based. This can fall into 2 different categories, those
    a. Fully employed but earnings do not exceed greater of minimum wage or 150% of federal poverty level applicable to borrower's family size and State residence; or

    b. Unemployed (not to exceed 6 months) AND
    Proof of eligibility to receive unemployment insurance; OR
    registered with an employment agency (if available) within 50 mile radius of residence AND made at least 6 attempts to secure full time employment in prior 6 months.

5. Military Deferments.

6. Student Deferments.

FORBEARANCE

This is similar to a deferment in some ways and can be any or all of the following:

1. A temporary stoppage of the payment obligation;
2. An extension of the time for making payments; or
3. An acceptance of smaller payments

PROS AND CONS. A forbearance is easier to obtain than a deferment. It can be granted even if the borrower is in default. On the other hand, interest will continue accruing even on a subsidized (non-interest accruing) loan.

GETTING OUT OF DEFAULT STATUS

Borrowers also frequently want to remove their loans from default status. This can be motivated by a number of causes, including avoidance of the recovery remedies available to the federal government and the private lenders. This can sometimes be accomplished by either Consolidation of existing loans or rehabilitating loans already in default status.

Consolidation out of default status.

ELIGIBILITY. A borrower can escape default status (and perhaps reduce his or her monthly payment) by consolidating his or her non-consolidation loans into a DIRECT Consolidation loan so long as he or she has at least 1 FFEL or DIRECT loan. A borrower CAN re-consolidate a defaulted DIRECT Consolidation loan but NOT a defaulted FFEL consolidation loan

REHABILITATION

Rehabilitation cures default status as well.

Requirements for Rehabilitation are:

1. FFEL and DIRECT loans can be rehabilitated by making 9 timely payments (within 20 days of the due dates) during 10 consecutive months
2. Similarly a Perkins loan can be rehabilitated by making 9 consecutive timely monthly payments.

Advantages and disadvantages of consolidation and rehabilitation.

Consolidation is quicker - no requirements of preliminary payments to qualify as in rehabilitation.

1. In rehabilitation the default notation is removed from the borrower's credit report but this benefit is frequently oversold by collectors.
2. In either case however, collection fees of up to 18.5% may be added to the principal balance.

Finally, borrowers may simply wish to reduce their monthly payment obligations. This can sometimes be accomplished through entering into 1 of several repayment plans tied to the borrower's income.

REPAYMENT PLANS TIED TO BORROWER'S INCOME

Repayment plans may reduce or even eliminate the borrower's payment obligations. There are 3 principal types which will be discussed in descending order of their benefits and attractiveness to borrowers. In addition, there are repayment plans available to Perkins loans which aren't covered by the IBR, ICR or ISP plans discussed below.

INCOME BASED REPAYMENT PLANS (IBR)

IBR's applies to FFEL and DIRECT loans. To qualify, the borrower must establish a partial financial hardship AND be in non-default status. After 25 years (20 for loans issued after July 1, 2014) the remaining loan balance can be forgiven (subject to numerous requirements and limitations). The government pays the accrued interest for up to 3 years.

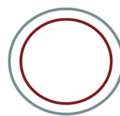
INCOME CONTINGENT REPAYMENT PLAN(ICR)

ICR's apply only to DIRECT loans. Its formula is generally not as favorable to borrowers as the IBR formula. ICR plans do not provide for government payment of accrued interest. Like IBR plans, it reduces payment amounts and provides for loan forgiveness after 25 years.

CAUTION: Under both IBR and ICR plans, the calculated monthly payment may not cover the full interest accrual amount.

INCOME SENSITIVE PLANS (ISP)

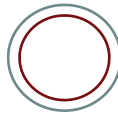
ISP's apply only to FFEL loans. The installment payments are adjusted annually based on the borrower's expected monthly gross income. Generally the formula for ISP's is less affordable than either IBR or IRC plans.



IN THE NEWS—Garnishment of Accounts Containing Federal Benefit Payments

A new Federal rule pertaining to garnishment of federal benefits, which are exempt from judgment creditors writs of garnishment, e.g., social security and SSI, was passed and took effect on May 1st, 2011.

No longer will financial institutions be able to claim they do not know or are not required to determine whether such exempt funds are in accounts when served with writs. The Rule REQUIRES the institutions to determine the source of the funds in the account when served with a writ and also REQUIRES them to withhold 2 months' benefits.



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