Dealing with the Burden of Student Loans in Your First Years of Practice

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For most of us who practice law, the education required to enter the profession would not have been possible without the aid of federally insured or -originated student loans. Such loans have been made available through non-profit, for-profit and government agency lenders for nearly 35 years based upon the promise of the federal government to repay the debt if the student borrower fails to do so. As a business proposition it is difficult to imagine any other circumstance under which a lender would make an unsecured loan to an unemployed student who generally has no credit history, and will relocate numerous times prior to and during loan repayment. Since 1993 the federal government has offered to make such loans directly to students attending certain participating institutions. This article will lay out for you the basics of the federally guaranteed student loan program (FFELP) and the direct loan program offered by the U.S. Department of Education (FDLP); who the players are; a three-step approach to managing your student loan debt load; and, finally, a brief but important discussion about the consequences of defaulting on your student loan debt.

The FFELP and FDLP are authorized by the Higher Education Act of 1965, as amended (the "Act"), Title IV, Parts B (20 U.S.C 1071 *et seq.*) and D (20 U.S.C. 1087 *et seq.*), respectively. The U.S. Department of Education (DE) is the agency charged with promulgating regulations under the Act. Both the Act and the regulations have been extensively amended in recent years, including the reauthorization of the Act by Congress in 1998 and newly proposed regulations published by DE this summer.

There are several key players in the FFELP program. The original lender is the party named on the promissory note. Student loan notes, however, are frequently sold in the secondary market. Both the seller and the purchaser are required to notify the borrower of the change of ownership. A guaranty agency acts as the middleman between the lender and DE. It enters into a contract with the lender, promising to purchase the loan under certain circumstances, such as the borrower failing to repay the debt. The guarantor also enters into a "reinsurance" agreement with DE under which it can submit the defaulted loan to DE for payment after it has exhausted required collection attempts. Unless and until the borrower becomes more than 60 days delinquent in repaying the debt, he or she will not interface with the guaranty agency at all. Many lenders do not service the loans they hold. Thus another party involved in the process may be a loan servicer. A few of the largest student loan servicers in the nation are SallieMae, Unipac, InTuition, Inc., AFSA Data Corporation and USA Group Loan Services, Inc. In the FDLP, DE is the lender. Although the 1998 amendments to the Act allow DE to sell student loan assets in the secondary market, no such sales have occurred to date. In this program there is no guaranty agency involved, but loans are placed with independent contractors for servicing.

Three-Step Approach to Managing Your Student Loan Debt

Step One: Create an Inventory of Student Loan Debt

There are several types of student loans that you may have obtained. The most common which are available under either FFELP or FDLP are Stafford (subsidized and unsubsidized), PLUS (parent loan) and consolidation loans. Perkins loans are available directly from the school. Subsidized Stafford and Perkins loans are based upon need, PLUS loans are available to parents without a negative credit history, and unsubsidized Stafford and consolidation loans are available without regard to need or credit. The terms of each loan type vary. The interest rate on Stafford and PLUS loans obtained after October 1, 1992 varies each 12-month period based upon the 91-day Treasury bill. Older loans have a maximum rate of 9 percent and 10 percent, respectively; newer loans have a maximum rate of 8.25 percent and 9 percent, respectively. Perkins loans bear interest at 5 percent. It is important to note that these loans are simple interest-bearing instruments. Interest accrues and is generally billed to the borrower monthly along with an amortized amount of principal due. If you obtained an unsubsidized Stafford loan

and elected not to pay the interest while in school, that amount of interest is capitalized and added to the principal due on your loan.

After you have identified which loan types you have obtained, create an inventory of the holder of each loan, the interest rate it bears, and when it enters into repayment. Several large lenders including SallieMae, DE, Bank One, Wells Fargo Bank and Bank of America have created interactive Web sites where you may access your account information online to retrieve the answers to the questions posed above. If you have obtained loans from several different lenders during your college and law school years, and would prefer to consolidate all such loans with one lender resulting in one monthly payment, consider a consolidation loan. You may approach any one of your lenders to request such a loan. Currently, the interest rate will be the weighted average of all loans consolidated rounded up to the nearest 1/8 percent with a maximum rate of 8.25 percent.

Step Two: Consider All Repayment Options

Stafford and Perkins loans have a six-month grace period following completion of school before repayment begins. PLUS and consolidation loans generally begin repayment within 60 days following receipt of the loan funds. All but consolidation loans must be repaid within 10 years; however, several repayment options are available.

You should choose the repayment option that best suits your needs. In the FFELP you have three choices: level payments, graduated payments or income-sensitive payments. Level payments are just that—equal monthly payments representing accrued interest and principal calculated to repay the loan in 10 years. If your debt burden is high and your starting income relatively low, graduated or income-sensitive payments may better suit your needs. Graduated payments will be lower at first and increase over time; income-sensitive payments rise and fall based upon your yearly income. Borrowers under the FDLP may choose income-contingent rather than income-sensitive repayment. Both operate under the same principle. A Perkins loan must be repaid in equal monthly installments.

Step Three: Communicate With Lender During Repayment

Several types of deferments and forbearances are available under the Act. For example, you can defer repayment of your federal loan if you are participating in a graduate fellowship program, temporarily totally disabled, or conscientiously seeking but unable to find employment. A deferment is also available if you are enrolled in school at least half-time, and you have obtained an additional loan during that period of enrollment. In addition to the deferments outlined above, your lender has the ability to forbear repayment of your loan under certain circumstances, such as poor health or other unforeseen personal problems. Your lender understands that repayment of your loan may be very difficult at times, if not impossible. If the circumstances are temporary and you fully intend to get back on track as soon as possible, I assure you that your lender would rather work with you than have you default on the loan. You should understand, however, that interest will continue to accrue during such period (unless paid by the government on a subsidized loan), and will be capitalized and added to the principal amount of your loan at the end of such period. You are also responsible for letting your lender know when your address or telephone number change.

The Consequences of Failing to Repay Your Student Loan Debt

As an attorney who has represented a student loan lender for the better part of seven years, I have heard the phrase "[I]f only I had known" countless times. "If only I had known"…that if my monthly payment was more than 60 days late such delinquency would be reported to a national credit bureau and my credit history marred. "If only I had known"…that a student loan is not dischargable in a bankruptcy proceeding absent dire financial circumstances. "If only I had known"…that failing to repay my student loan would make it difficult if not impossible to obtain a mortgage loan 10 years after the fact. "If only I had known"...that the Internal Revenue Service has the ability to intercept any tax refunds that I would otherwise receive and apply the money toward my defaulted student loan. The nation's taxpayers ultimately foot the bill when student borrowers fail to repay their debt. It is therefore not surprising that the federal government has made default a painful process with lasting side effects. If you are struggling to repay your debt, see Steps Two and Three above. If a different repayment plan or a temporary forbearance do not solve the problem, consider a consolidation loan. Since the repayment period is based upon the total amount of the loan, several 10-year Stafford loans in the aggregate may become one 20- to 30-year consolidation loan, thereby greatly reducing your monthly payment. The ultimate cost of your borrowing, however, will be greater due to the extended payment of accrued interest. Consolidation loans are also available to pay off prior defaulted student loans and eliminate negative credit bureau information upon certain conditions being met.

For more detailed information about FFELP and FDLP, I refer you to the following Web sites:

www.sssc.com
www.salliemae.com
www.ed.gov/prog_info/SFA/StudentGuide/1999-0/index.html
www.ed.gov/DirectLoan

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