

Bonus Book

Walk away from your student loans.

How to guide for eliminating your student loan

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Legal Issues

Bankruptcy

One of the first questions that come to a student's mind, when they are experiencing financial hardship, is can I file for bankruptcy. The easy answer is no. The more complicated answer is yes, but only if you can prove undue hardship.

Financial or undue hardship is a difficult thing to prove to the courts, and any student considering this option needs to consult with a bankruptcy expert, specifically an expert that has dealt with student loan bankruptcies. This expert will be able to make the person completely aware of every option available to them.

One thing that will happen, should you decide to try for a bankruptcy ruling, is that any collection attempts that are currently in progress will be immediately stopped until the court makes a ruling on your case. It is possible, although unlikely, that your creditors could apply to the courts to have collection proceedings start again.

There is one last consideration before you proceed with a bankruptcy filing, and that is co-signers. Should you have co-signers or someone who endorsed the loan, they will not be discharged from their obligations. All co-signers and endorsers will be held responsible for repayment of your student loans.

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How to Get Started

Your first step will be to file a lawsuit under the particular bankruptcy law you have decided to use. This could be Chapter 7, Chapter 11 or Chapter 13. Next you will file an adversary proceeding against the institution who gave you the loan. Last step will be to prepare to go to trial.

Take into consideration the cost of this process as it is very expensive.

Undue Hardship

If you can show undue hardship to you, your family or dependents to the courts, there is a small likelihood that they will grant your bankruptcy application.

Different courts will evaluate your application according to their criteria. Under the bankruptcy code there is "no" definition of "undue hardship". One test that is often used is the Brunner test. The criteria for this test are:

- ☐ you are unable to keep up a normal standard of living based on your monthly income, less expenses which include your student loans
- ☐ the circumstances will be ongoing and will make it impossible for you to repay your loan. These circumstances will most likely last the total time period of your student debt.

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- ☐ you must be able to show that you have made every effort to try and repay your loans

Not all courts will use this test. Some courts will require more stringent rules be applied while others will go easier on students in financial trouble. Even if your application is denied, you can, in the future apply again if your circumstances warrant it.

Many courts are beginning to recognize the unfairness of the system for student loans. As such, they may give a student partial relief by allowing some of the debt to be discharged, but not the entire debt. Some will remove collection fees as well as accrued interest.

What any particular judge decides will depend a lot on where you live and who the judge may be. Your bankruptcy lawyer can give you more advice on what and who you may face in your circumstances.

If the courts grant your bankruptcy your student loans will be immediately canceled in full. Students must also take into consideration that if the bankruptcy is granted it will stay on their record for 10 years. This can make future loan and credit card applications very difficult to get approved. You will also be limited as to how often you can file for bankruptcy in the future. One must also consider the cost of filing for bankruptcy, whether approved or not.

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Other Bankruptcy Possibilities

Not all student loans are created equally. If a student can prove that their loan was not an actual education loan, then other options are available. Students need to check the Bankruptcy Code to ensure their loan is defined as a student loan. The institution that you attended must be declared an "eligible educational institution" in order to qualify as a true student loan. If your loan does not qualify, then your bankruptcy filing may not need to include undue hardship.

At one time, prior to 2005, private loans to students were treated differently in a bankruptcy court. This is no longer the case.

Filing for Chapter 13

If you are not able to show "undue hardship" in a bankruptcy court, filing for Chapter 13 could be an option for you. Although it is referred to as a bankruptcy, what it is in reality is a way for students to reorganize their debts to something that is more suitable to their financial circumstances.

With a Chapter 13 you will be able to include all debts. This can include car loans, a mortgage on a home and credit cards, to name a few. One of the main advantages of going this route is that your creditors will not have any say in what your payments will be. You will draw up your own repayment plan with the help of a bankruptcy lawyer and present it to the courts. If approved, then the plan will be implemented by the courts.

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One drawback to this option is that they expect the plan to be executed within 3 to 5 years. Any monies owing on your student loans after this time will still have to be repaid. At this time you can either pay your loans or try filing for bankruptcy using undue hardship. New rules now state that when your income is over the median income of your state you will be required to repay debts using the 5 year plan.

During the repayment period there can be no action taken against you by collection agencies. In some areas of the country a judge may even allow you to give your student loans a higher priority than other debts. A bankruptcy lawyer can help explain the different options available to you in the area you currently live in.

In formulating your plan you must take into consideration that courts will use IRS guidelines, in order to determine the amount of money you can allow for normal living expenses. The IRS guidelines are extremely strict and it's unlikely that any court will alter these guidelines.

You also need to be aware that recently passed laws state that not all debts can be discharged. If you have recently run up your credit card with purchases, they will not be allowed in the filing. New laws also state that you will be expected to attend counseling sessions within 6 months of making a filing and you will also be expected to attend education classes for debtors. You will be responsible for the cost of these classes.

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Proposed Changes for Student Loan Bankruptcy Filings

In April of 2010, two changes were proposed by a number of US Congressmen and Senators that will have a direct effect on the ability of students to file for bankruptcy in order to discharge their student loans. One change being proposed is the "Fairness for Struggling Students Act" and the other is the "Private Student Loan Bankruptcy Fairness Act".

These acts recognize that the current laws with regard to private student loans, both private from banks and from credit institutions, have been lumped together with other student loans. The end result being that they are nearly impossible for a student to discharge in bankruptcy.

The committees have recognized the legal rules are so stringent that many bankruptcy trustees will not even attempt to help students who are trying to prove undue hardship. With this, in mind, as well as the unfairness of the situations students face compared to other consumers, both the senate and the house have come forward with proposals to help students.

Currently student loans have a protected status due to legislation being passed in 2005. Prior to that time students with loans enjoyed the same status as those with outstanding debt on credit cards, private loans and car loans. These loans, at that time, could be discharged in bankruptcy.

Fearing abuse of the system, President George W. Bush signed into law the "Bankruptcy Abuse Prevention and Consumer Protection Act". This act

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was intended to prevent abuses to the system and protect lenders. Before passing, a provision was added that included private student loans being treated the same as federal education loans. The end result was to give more protection to private lenders. This put them on the same level as government loans.

Those who wanted to pursue their education were penalized, in that private lenders no longer followed rules to lend responsibly and allowed students to create unrealistic debt that in the future they would experience trouble repaying. The new law, when passed, will hold lenders accountable again and will offer a level of protection to students from those companies that practice abusive lending. This should help to make education more affordable for students in the future.

The government is now looking to change the laws by redefining student loans that are from private lenders. The objective is to change them back to private consumer loans. Once this is accomplished, then students experiencing difficulties will again be able to file for bankruptcy in order to discharge their private student debts. This will bring back a level of fairness to the process.

These inequities are currently recognized by some court judges and one of the reasons that some judges are willing to lean more toward the student's plight in current bankruptcy proceedings. This will have no affect on federal student loans, and filing for bankruptcy for federal loans will be a near impossibility. This was also the case prior to the 2005 legislation.

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Currently private loans lack any consumer protections for students that they would normally find with federal loans. They lack:

- ☐ capped or fixed interest rates
- ☐ repayment plans based on income
- ☐ deferment options for payment

Should a student be faced with unemployment, financial distress, disability or illness they have no options available to them when it comes to private loans. Rarely are they able to work with the lending institution to come up with a plan that will enable them to have a payment schedule that is fair and reasonable. Some students have also been faced with rates of interest that can be in the double digit range. Compared to government loans, they often see themselves paying as much as 3 times the interest rate.

Consumer Advocacy Groups

Consumer advocacy groups have long held the belief that students are treated more harshly than other consumers. This is due to the belief that lenders saw students as a group that was more likely to abuse the system than others. There has never been any evidence that would back up this claim and yet it was part of reason for the 2005 legislation being amended.

Advocacy groups have long pointed out the predatory lending practices of

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student loans from private institutions. They've also compared them to subprime lending, in that people are unable to access reasonable rates in order to repay their loans. They note that these companies:

- ☐ have poor underwriting
- ☐ they lend to students in an irresponsible manner
- ☐ charge very high fees
- ☐ have origination fees that can top 10%
- ☐ Variable interest rates that can go higher than 20%

All the above factors have left students in a precarious position should they be unable to repay their loans due to any of the above discussed issues.

Passing the Legislation

As of November, 2010, the legislation is still pending and is not likely to pass before year end. When the new Republican house resumes in the New Year it is unclear whether they will approve passage of the two bills.

Republicans have concerns about the bills in their current state and feel the allowing students to discharge loans in bankruptcy is not a viable solution. It is felt that Republicans may want to add more protections for private lenders. If the current bill is passed they feel that private lending may dry up and adversely affect future students seeking loans.

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To follow the two bills before congress you can visit the following government links.

Fairness for Struggling Students Act

<http://thomas.loc.gov/cgi-bin/query/z?c111:S.3219:>

Private Student Loan Bankruptcy Fairness Act

<http://thomas.loc.gov/cgi-bin/query/z?c111:H.R.5043:>