

THE DARK SIDE OF STUDENT LOANS: DEBT BURDEN, DEFAULT, AND BANKRUPTCY[©]

BY SAUL SCHWARTZ*

This article addresses three hypotheses: (1) only a minority of Canadian student loan borrowers experience severe difficulty in repaying their student loans; (2) those who default on their student loans do so largely because they cannot pay, rather than because they do not want to pay; and (3) for Canadians who are filing for bankruptcy and who have student loans among their debts, bankruptcy is a last resort, and their economic situation is more difficult than that of the average person seeking bankruptcy protection. A review of the literature strongly supports the first two hypotheses; a new analysis of a 1997 survey of debtors seeking bankruptcy protection supports the third. The author concludes that most debtors with student loans among their debts are not behaving opportunistically in seeking bankruptcy; bankruptcy is indeed a last resort. The article questions whether recent legislative changes, which impose a ten-year waiting period before allowing the discharge of student loan debt through bankruptcy, are motivated by an assumption of opportunistic behaviour on the part of student loan borrowers. The author believes those changes are unwise and unnecessary.

Cet article répond à trois hypothèses: (1) seulement une minorité d'étudiants en tant qu'emprunteurs ont d'énormes difficultés à repayer leurs dettes; (2) si certains sont en défaut de rembourser leurs emprunts, c'est plutôt parce qu'ils ne peuvent pas et non parce qu'ils ne veulent pas le faire; et (3) pour les Canadiens qui sont en instance de faillite et qui ont des emprunts d'étudiants dans leurs dettes, la faillite est leur dernier recours, et leur situation économique est plus difficile que celle de la moyenne des gens qui cherchent la protection de la faillite. Une relecture de la documentation soutient bien les deux premières hypothèses; une nouvelle analyse d'une étude réalisée en 1997 sur les débiteurs cherchant une protection de la faillite, soutient la troisième. L'auteur en conclut que la plupart des débiteurs qui ont des emprunts d'étudiants dans leurs dettes, ne se comportent pas de façon opportuniste en cherchant la protection; la faillite est en fait leur dernier recours. L'article se demande si les changements législatifs récents, qui imposent une période d'attente de dix ans avant de permettre de décharger les emprunts d'étudiants des dettes à travers la faillite, sont motivés par la présomption d'un comportement opportuniste de la part des débiteurs. L'auteur croit que ces changements ne sont ni prudents ni nécessaires.

I. INTRODUCTION	308
A. <i>Background</i>	309
II. HOW MANY BORROWERS EXPERIENCE FINANCIAL HARDSHIP IN REPAYING THEIR LOANS?	312

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A. <i>Early Efforts to Quantify Financial Hardship</i>	314
B. <i>Measuring Hardship Using Survey Data</i>	314
C. <i>Measuring Hardship Using Administrative Data</i>	317
III. WHY DO STUDENTS DEFAULT?	318
A. <i>Borrowers' Inability to Pay</i>	319
B. <i>Knowledge and Attitudes</i>	321
C. <i>Incentives for Default Created by Program Rules</i>	322
1. Eligibility rules	323
2. Due diligence rules	323
3. Lack of flexible repayment plans	324
4. Consequences of default	324
IV. THE SITUATION OF BANKRUPTS WITH STUDENT LOANS AMONG THEIR DEBTS	325
A. <i>Demographic Characteristics</i>	326
B. <i>The Economic Situation of Bankrupts With Student Loan Debt</i>	327
C. <i>Summary</i>	330
V. RECENT LEGISLATIVE CHANGES THAT RELATE TO STUDENT LOAN BORROWERS	330
A. <i>Changes to the CSLP Interest Relief Program and "Debt Reduction" for CSLP Loans</i>	334
B. <i>Tax Credits for All Student Loan Borrowers</i>	336
C. <i>New Grant Programs</i>	337
VI. CONCLUSION	337

I. INTRODUCTION

In this article, I discuss three hypotheses: (1) only a minority of Canadian student loan borrowers experience severe difficulty in repaying their student loans; (2) those who default on their student loans do so largely because they cannot pay, rather than because they do not want to pay; and (3) for Canadians who are filing for bankruptcy and who have student loans among their debts, bankruptcy is a last resort; their economic situation is even more difficult than that of the average person seeking bankruptcy protection.

The first two hypotheses are supported by a review of previous research.¹ The third relies on evidence from a survey of Canadians who filed for personal bankruptcy in 1997.² After presenting the evidence relating to the three hypotheses, I then discuss recent important legislative changes that affect the student loan systems.

A. Background

More than 40 per cent of Canadian young people are enrolled in post-secondary schools. That percentage is higher than in the United States, higher than in the United Kingdom and, in fact, higher than in any other Organization for Economic Co-operation and Development (OECD) country.³ In 1995-1996, roughly 960,000 Canadians were full-time students in colleges or universities.⁴

¹ Parts I and II of the article are drawn from literature reviews written for Human Resources Development Canada (HRDC). These literature reviews were part of an evaluation of the Canada Student Loan Program (CSLP), conducted by Goss Gilroy Inc. on behalf of HRDC: see Human Resources Development Canada, *Evaluation of the Canada Student Loan Program: Final Report* (Ottawa: Human Resources Development Canada, 1997), online: Human Resources Development Canada <<http://198.103.247.24/edd/CSL.html>> (date accessed: 11 September 1999) [hereinafter *Evaluation: Final Report*]. The first review dealt with student loan default: see S. Schwartz & S. Phillips, *Student Loan Default* (1996) [unpublished, on file with author]; the second review dealt more generally with the issues related to student loan borrowing: see S. Schwartz, *Evaluation of the Canada Student Loans Program: Literature Review* (1996) [unpublished, on file with author].

² See S. Schwartz & L. Anderson, *An Empirical Study of Canadians Seeking Personal Bankruptcy Protection* (Ottawa: Industry Canada, 1998), online: Industry Canada <<http://strategis.ic.gc.ca/SSG/ca00889e.html>> (date accessed: 11 June 1999) [hereinafter *Empirical Study*]. This report was the work of myself and Leigh Anderson of Carleton University, and was derived from our survey of bankrupts: see S. Schwartz & L. Anderson, *1997 Survey of Potential Bankrupts* (1997) [unpublished, on file with author] [hereinafter *Survey of Potential Bankrupts*]. The actual survey process was undertaken with the assistance of Steve Kiar of COMPAS Inc., an Ottawa survey research firm.

³ The percentages are for young people, aged 18-21, in countries that are members of the Organization for Economic Co-operation and Development (OECD): see Organization for Economic Co-operation and Development, *Education at a Glance: OECD Indicators* (Paris: Organization for Economic Co-operation And Development, 1996) at 126-27.

⁴ See Canada, *Federal and Provincial Support to Post-Secondary Education: A Report to Parliament 1991/92-1995/96* (Ottawa: Department of the Secretary of State, 1997) at 29-30. Of the 960,000 students, 387,000 were enrolled in colleges and 573,000 in universities; another 433,000 Canadians were studying on a part-time basis (160,000 in colleges and 273,000 in universities). These totals do not include students in private colleges or in short-term trade and vocational programs. Statistics Canada estimated that there were 306,000 such students at one point in time during the 1993-1994 academic year: see Statistics Canada, *Education in Canada* (Ottawa: Statistics Canada, 1996). As these programs are relatively short, the number of students enrolled in them over

A substantial proportion of Canadian post-secondary students borrow from government-subsidized loan programs in order to help finance their schooling. In 1995-1996, 321,000 students borrowed from the Canada Student Loans Program (CSLP), and more borrowed from provincial loan programs.⁵

The job market faced by young people after leaving school is complex and uncertain. For those who *graduate* from college and university programs, employment and earnings have been relatively strong and stable over time. According to the National Graduates Surveys (NGS), 80 per cent of those who graduated from bachelor degree programs in 1982, 1986, or 1990 were working full-time five years after graduation.⁶ Over time, the full-time earnings of the graduates were consistently high.⁷ Thus, post-secondary education continues to pay off for at least some young people. The growth of post-secondary enrolments through the early 1990s, despite declining numbers of young people in the population, confirms that impression.⁸

Two other factors, however, bear on this situation. The first is that, since the 1980s, the earnings of young people have, on the whole, been falling. As the average earnings of post-secondary graduates has been stable, it would seem that the earnings of the large number of young people who have some post-secondary education, but no post-secondary degree, have been declining. The second factor is that a significant minority of graduates work—at least initially—in jobs that do

the course of a year may be larger than that estimate.

⁵ Students in all approved post-secondary programs are eligible to borrow from the CSLP (subject to provincial needs assessment). Approved programs include public colleges and universities, as well as private colleges and short-term vocational programs. Since we do not know the number of students in private colleges and short-term vocational programs (see note 4, *supra*), we do not know the number of eligible students and, therefore, do not know the proportion of all eligible students who borrow.

⁶ See M. Paju, *The Class of '90 Revisited: Report of the 1995 Follow-up Survey of 1990 Graduates* (Ottawa: Human Resources Development Canada, 1997) at 9-10.

⁷ Across the three cohorts, male graduates had (in constant 1990 dollars) average full-time earnings in the \$33,000-\$34,000 range, while female graduates had average full-time earnings in the \$29,000-\$30,000 range: see R. Finnie & S. Schwartz, *Student Loans in Canada: An Economic Analysis of Borrowing and Repayment Using the National Graduates Surveys* (Ottawa: Human Resources Development Canada, 1996) Table 3.

⁸ The number of Canadians between the ages of 15 and 24 was roughly 4.5 million in 1985. The number had fallen to roughly 4 million in 1990, and remained at that level in 1995: see G. Betcherman & N. Leckie, *Youth Employment and Education Trends in the 1980s and 1990s* (Ottawa: Canadian Policy Research Networks, 1997) at 3. The proportion of each age group enrolled in colleges and universities has also risen over time. For example, according to Gordon Betcherman and Norman Leckie, 17.2 per cent of those between the ages of 18 and 21 were enrolled in university in 1993-1994, compared to 15.7 per cent in 1989-1990. College enrolment rates rose as well: *ibid.* at 28.

not require a post-secondary education. Richard Marquardt reports that “[a]mong male university graduates, 28% were working at jobs ... [that] were primarily in clerical, sales, and service occupations, for example, stock clerks, sales clerks, waiters, and security guards.”⁹ These trends suggest that post-secondary education is a risky undertaking, with no guarantee that the resources invested in it will bear fruit in the form of better jobs and higher earnings.¹⁰

The cost to students of making an investment in post-secondary education has risen substantially in recent years. The financial pressure felt by post-secondary schools in the wake of federal and provincial cutbacks has led schools to increase tuition fees sharply. The Statistics Canada Tuition Fee Price Index has moved steadily upward during the 1990s,¹¹ rising more quickly than the Consumer Price Index.¹² Thus, post-secondary education is not only risky, but it is costlier than it once was.

As tuition fees increased, so did the need for government-subsidized student financial aid. Governments made that aid available, but did so by increasing the amounts that students were allowed to borrow from student loan programs. On the federal side, the CSLP loan limit was increased by about 50 per cent in 1994. On the provincial side, the provinces eliminated many of their grant programs in the early 1990s and replaced them with loan programs.

The greater reliance on student loans creates two problems for borrowers. First, the calculus of benefit and cost has changed for students considering an investment in higher education. Some students, who might have made the investment when grants were more widely available, may potentially decide against attending school, or might leave prematurely for financial reasons. Since the substitution of loans for

⁹ R. Marquardt, “Labour Market Participation, Employment and Unemployment” in *High School May Not Be Enough: An Analysis of Results From the School Leavers Follow-up Survey, 1995* (Ottawa: Human Resources Development Canada, 1998) 29 at 37.

¹⁰ We cannot tell from the available research whether post-secondary education has become more risky over time. For example, we do not know what has happened to either the level or the variance in the rate of return to the different types of post-secondary education.

¹¹ See, for example, T.M. Omiecinski, “Tuition and Living Accommodation Costs at Canadian Universities, 1996-97” (1997) 4:1 *Educ. Q. Rev.* 92 at 92; 94, Table 1.

¹² *Ibid.* at 95, Graph 1. Tuition fees, however, are not the major cost of post-secondary schooling. The major economic cost is the earnings foregone by students. Since youth unemployment rates have been relatively high in the 1990s, and since real average earnings have fallen, the opportunity cost of the time spent in school has probably declined for many Canadians. The magnitude of that decline is unknown, however, and thus cannot be compared to the increase in tuition fees.

grants primarily affects low-income Canadian youth—student aid is based on family income—their access to post-secondary education may be jeopardized.

Second, some of the students who decide to borrow in order to obtain further education or training will not only incur significant costs, but will also accumulate high debt loads. For them, the burden of debt repayment may create severe financial problems when they leave school.

A third problem does not affect borrowers directly, but is important nonetheless. Student loan programs are expensive. The cost borne by the government has led to recent program changes and seems likely to lead to more changes in the future. Student loans are subsidized in two ways, both of which involve substantial costs to the federal and provincial governments. First, the governments pay the interest on student loans from the time the student borrows, until six months after the student has left full-time studies. Second, governments bear some of the costs of default. Depending on the loan program, the governments either guarantee the loans (so that lenders are paid the value of defaulted loans plus interest), or pay lenders a fee in lieu of a guarantee.

The focus of this article is on the second problem—the burden of debt repayment.

II. HOW MANY BORROWERS EXPERIENCE FINANCIAL HARDSHIP IN REPAYING THEIR LOANS?

Almost by definition, paying back a loan imposes a financial burden on the borrower. The relevant question here is whether the burden is so great as to threaten the financial well-being of the borrower. Since student loans are offered to young people without any consideration of their future ability to repay, fears about excessive borrowing have been voiced ever since Canadian student loan programs were introduced in the 1960s. In this section, I review previous research on the extent to which former students are overburdened by their loans.

Efforts to measure how many student loan borrowers face financial hardship as they attempt to repay their loans have had to deal with two difficult issues. First, any definition of “financial hardship” is inherently subjective. In the different, but related, context of assessing the ability of potential bankrupts to pay their debts, Teresa Sullivan, Elizabeth Warren, and Jay Westbrook wrote:

“How many debtors can pay?” is in part a normative question: the answer depends on moral and social value judgments. ... All of us might prefer to skip paying our monthly bills in favor of having a party or buying a new car, but we would hardly claim that this

preference made us unable to pay. On the other hand, nearly all of us would agree that an elderly widow with few assets, living on her social security, "can't pay" the massive debts left by the failure of her late husband's business.¹³

Thus, there is no consensus on exactly what financial hardship might mean. In a discussion of loan debt, Janet Hansen wrote that "[r]esearchers have never been able to agree on what level of debt is likely to be manageable for those who borrow to pay for college; given this lack of consensus, it becomes difficult for policymakers to know if and when the point of 'too much' borrowing is reached."¹⁴

A second problem is that very few data sets are rich enough to contain all debts that a former student might have incurred. Student loan debts are only one of a number of debts by which young people might be burdened. For example, many young people use credit cards and might, therefore, have outstanding balances on them. Others borrow to purchase automobiles and homes. As student loans may not be the only loans that young people are trying to repay, individuals with identical amounts of outstanding student loan debt might have quite different debt repayment burdens. A person who might easily pay off \$10,000 in student loans, if that were his or her only debt, might be struggling desperately to repay such a loan if accompanied by a \$5,000 credit card balance and a \$15,000 car loan. Without data on all debt obligations, no measure of financial hardship can be complete.

Faced with these challenges, researchers have tried three general lines of attack. First, an early group of studies estimated the proportion of a typical starting salary that might reasonably be spent on debt repayment and then compared that proportion to the amount required to repay debts of various amounts. Second, researchers used survey data either to calculate rough indicators of debt burden or to ask debtors directly whether or not their loans were causing financial hardship. Other researchers used survey data to approach the issue indirectly by looking at various aspects of the economic situation of student loan borrowers (such as their access to credit or their propensity to purchase major consumer durables). Third, administrative data on the incidence of student loan default and of bankruptcies involving student loans has been analyzed on the assumption that default and bankruptcy indicate financial hardship.

¹³ T.A. Sullivan, E. Warren & J.L. Westbrook, *As We Forgive Our Debtors: Bankruptcy and Consumer Credit in America* (New York: Oxford University Press, 1989) at 200 [hereinafter *As We Forgive Our Debtors*].

¹⁴ J.S. Hansen, "The Shifting Roles of Parents and Students" in J.P. Merisotis, ed., *The Changing Dimensions of Student Aid* (San Francisco: Jossey-Bass, 1991) 21 at 25-26.

A. *Early Efforts to Quantify Financial Hardship*

Early studies of the burden created by student loan repayment relied largely on rough theoretical measures derived from aggregate borrowing patterns.¹⁵ Summarizing this literature, Sandy Baum and I wrote:

Previous studies have estimated “manageable” debt levels based on the proportion of starting income which can reasonably be devoted to repayment The consensus of this literature is that students graduating from college in the mid-1980’s can be expected to successfully manage debts up to between \$5,000 and \$8,000. Beyond these levels, debts are thought to cause unreasonable burdens.¹⁶

In the absence of survey data that included flows of both debt repayment obligations and income, no calculation of the proportion of former students facing unmanageable student loan debts could be attempted. As a result, these studies were used primarily to advise governments on where to set borrowing limits, and to advise students on how much debt they might reasonably be able to repay.

B. *Measuring Hardship Using Survey Data*

A second group of studies turned to survey data that measured the individual circumstances of particular borrowers. One way to measure hardship in the survey data is simply to ask borrowers if they are experiencing financial hardship as they repay their loans.

¹⁵ André Danière provides an early example of an effort made to develop a rough theoretical indicator of the burden created by student loan repayment: see A. Danière, “The Benefits and Costs of Alternative Federal Programs of Financial Aid to College Students” in *The Economics and Financing of Higher Education in the United States: A Compendium of Papers Submitted to the Joint Economic Committee, Congress of the United States* (Washington, D.C.: U.S. Government Printing Office, 1969) 556. Danière defines, at 577, what he considers to be a “comfortable repayment stream.” Using United States census data, he then assumes that the average person spends 90 per cent of after-tax income on consumption goods (*i.e.*, food, shelter, and any other expenses that are not “savings”). Of the remaining 10 per cent, Danière reasons, at 578, that one-quarter should be spent on “securing life insurance, providing emergency funds, etc.” The remaining 7.5 per cent of after-tax income is described, at 578, as the “average ‘comfortable’ repayment amount.” Danière writes, at 576, that the amount of debt burden that is “tolerable” should be based on “a social consensus of what constitutes tolerability.” He undertook this calculation only to facilitate his numerical simulations of debt burden. Other authors simply adopt the standards developed by banks for extending credit. These include ratios of mortgage-debt service to pre-tax income in the 25 per cent range, and ratios of total-debt service to pre-tax income in the 40 per cent range.

¹⁶ S. Baum & S. Schwartz, *The Impact of Student Loans on Borrowers: Consumption Patterns and Attitudes Towards Repayment: Evidence from the New England Student Loan Survey* (Boston: Tufts University, 1988) at 17, n. 7 [hereinafter *Impact of Student Loans*].

For example, Baum and I surveyed about 2,000 American student loan borrowers who were in the repayment phase and whose loans were guaranteed by the Massachusetts Higher Education Assistance Corporation. Our analysis was specifically aimed at investigating “the extent to which educational debt is burdensome for borrowers”¹⁷

Baum and I asked several questions designed to elicit respondents’ subjective impressions of the burden of loan repayment. We summarized the results of those questions as follows: “Based on the responses, we estimate that approximately 30% [of the respondents] perceive significant hardship resulting from their loan repayment. About one-half of the respondents do not perceive measurable hardship.”¹⁸

In the Canadian context, Ross Finnie and I used the NGS data to analyze the burden of student loan repayment for Canadian borrowers who had graduated from a post-secondary institution.¹⁹ The NGS asked graduates who had student loans outstanding whether they felt that repaying their student loans was a hardship. According to Finnie and I, 19 per cent of the male graduates and 26 per cent of the female graduates reported hardship.²⁰

Finnie and I also used the NGS data to examine the ratio of total student debt to earnings.²¹ This ratio understated the true debt burden facing the graduates for at least two reasons. First, debts other than student loans were omitted (since they were not reported in the NGS). Second, those who were not working were omitted (since they had no earnings and, thus, had an undefined ratio of debt to earnings). For those who received bachelor’s degrees in 1990, the median debt-to-

¹⁷ *Ibid.* at 3.

¹⁸ *Ibid.* at 7.

¹⁹ See R. Finnie & S. Schwartz, *Student Loans in Canada: Past, Present, and Future* (Toronto: C.D. Howe Institute, 1996) at 36-54 [hereinafter *Student Loans in Canada*]. The NGS surveyed those who had graduated from Canadian post-secondary institutions in 1982, 1986, and 1990, a particularly well-off group of borrowers. We know from studies of student loan default that default rates are considerably lower among graduates than among non-graduates: see, for example, M. Dynarski, “Who Defaults on Student Loans? Findings From the National Postsecondary Aid Study” (1994) 13 *Econ. Educ. Rev.* 55 [hereinafter “Who Defaults on Student Loans?”]; and J.F. Volkwein & B.P. Szelest, “Individual and Campus Characteristics Associated With Student Loan Default” (1995) 36 *Res. Higher Educ.* 41.

²⁰ Since 65 per cent of the survey respondents did not have any outstanding student loan debt, Finnie and I suggest that, for those graduating from post-secondary institutions in the 1980s, student loan repayment was a problem for only about 7-8 per cent of the borrowers: see *Student Loans in Canada*, *supra* note 19 at 47.

²¹ Ideally, one would compare the flow of payments to the flow of income. The NGS, however, contains only the total amount borrowed by each respondent and not their monthly repayments.

earnings ratio was 0.28 for men and 0.32 for women. The ratios for other degree types and other cohorts were somewhat lower.

As a rough indicator of the substantive magnitude of Finnie's and my ratios, note that Sullivan, Warren and Westbrook estimated that the median ratio of "total non-mortgage debt to income" for their sample of American bankrupts was 0.7.²² The burden of student loans, however, is probably lower than the burden of an equivalent amount of "non-mortgage debt" because student loans are paid off over ten years (rather than the two or three years that is typical of non-mortgage debt) and, thus, requires smaller monthly payments.²³

Another potential impact of a debt burden that is too heavy would be the inability of former students to participate fully in life after leaving school. Some have argued that if students face too high a debt load upon leaving school, they will be forced to forego careers that are not remunerative, to postpone marriage, to postpone having children, or, in general, to be unable to participate fully in adult life.

Baum and I also asked our survey respondents if their loan repayment obligations had affected home-ownership, car ownership, or living apart from parents. At least in the United States, in 1988 (when average total student loan debts were between US\$6,000 and US\$9,000), repayment did not have any "significant impact on the actual consumption patterns of borrowers."²⁴ Baum and I concluded that "[t]he evidence strongly suggests ... that the loan payments are not significantly affecting the ability of repayers to enjoy the consumption patterns typical of similar borrowers without high loan payments."²⁵

Borrowing levels in Canada and in the United States continue to increase, and debt burdens continue to grow beyond the levels at which either borrowers or analysts have any experience. Despite long-standing and continuing concern about excessive debt burdens, students have continued to borrow. Thus, any dire predictions of the consequences of increased borrowing should at least be leavened with the knowledge that past fears have not been realized.

²² See *As We Forgive Our Debtors* *supra* note 13 at 206. In this calculation, only debtors who were not self-employed and who were filing under Chapter 7 were included.

²³ The literature on bankruptcy generally suggests (though without much theoretical or empirical support) that a debt-to-earnings ratio of one (that is, a debt load equal to one year's earnings) indicates that bankrupts "cannot pay" their debts.

²⁴ *Impact of Student Loans* *supra* note 16 at 12.

²⁵ *Ibid.* at 14.

C. Measuring Hardship Using Administrative Data

For more than thirty years, government-guaranteed loans from the CSLP have helped low-income students pay for their post-secondary education.²⁶ Low-income students are “high-risk” borrowers—with limited labour market experience and limited access to collateral. Private institutions are usually unwilling to make unsecured loans to such borrowers. That reluctance, combined with the government’s desire to make post-secondary education accessible to all, regardless of family income, was the rationale for providing the government guarantee.

The majority of student loan borrowers repaid their loans; the loans of the minority who did not repay fell into default. For loans negotiated before 1995, the government then made good on its guarantee by paying a claim for loss to the lender.²⁷ The borrower’s debt, however, was not discharged; “default” simply meant that the responsibility for collection shifted from the lending institution to the government.

As late as 1980, student loan default was not perceived as a great problem in some quarters. At that point, about 9 per cent of CSLP borrowers had defaulted on their loans.²⁸ By 1990, however, the proportion of borrowers who defaulted on their Canada Student Loans had climbed to “one in six,”²⁹ and the auditor general was quite

²⁶ See Human Resources Development Canada, *Ensuring Opportunities: Access to Post-Secondary Education* (Ottawa: Human Resources Development Canada, 1998) [hereinafter *Ensuring Opportunities*]; online: Human Resources Development Canada <http://www.hrdc-drhc.gc.ca/student_loans/postgraph/va3_e.html> (date accessed: 11 September 1999), which states that “[s]ince 1964, the federal government has provided over \$15 billion in financial assistance to 2.7 million students under the Program.”

²⁷ Before a loan is formally categorized as in “default,” the lender must verify that the loan has a number of characteristics. Similarly, defaulted loans must have a number of characteristics before the CSLP formally declares the value of a loan “lost.” In this article, however, I adopt a less formal notion of default and loss. A loan is in default if the lender has filed a claim for loss with the CSLP, and the CSLP has paid that claim.

²⁸ See The Federal-Provincial Task Force on Student Assistance, *Report of the Federal-Provincial Task Force on Student Assistance* (Toronto: Council of Ministers of Education, 1981) at 141, where the Task Force asserted that “[t]he amount ultimately requiring write-off to date is about 1% of the value of default claims paid.” However, this number does not seem justified by the statistics included in the report. Nonetheless, the Task Force concluded, at 143, that “the existing default rates on the CSLP and on provincial loans were not unduly out of line and did not point to any particular weakness or problems with the concept or administration of the programs.”

²⁹ See Office of the Auditor General, *Report of the Auditor General of Canada to the House of Commons* (Hull, Qc.: Supply and Services Canada, 1990) at 701 [hereinafter *Report of the Auditor General*].

concerned both about that rate and about the government's efforts to reduce it.

Combining estimates of the rate of default and the rate of repayment after default, Finnie and I estimate that between 10–12 per cent of the dollar value of student loans was lost through default.³⁰

Changes to the CSLP in the 1990s have significantly changed the nature of the problem of student loan default. The federal government does not guarantee CSLP loans negotiated after August 1995. Lending institutions receive a payment of 5 per cent of the value of all loans entering repayment—a payment called the “risk premium.” In return for the risk premium, the lending institutions bear the losses created by the former students who fail to repay their loans. The loss rates on the student loans made under this “risk-sharing” agreement will remain unknown for some time yet.

The role of student loans in personal bankruptcy is even less well documented. When Wayne Brighton and Justin Connidis studied those seeking bankruptcy protection in 1977,³¹ student loan debt was not an important element among the debts of those in their study sample. The increase in borrowing over time, however, had an impact on this extreme form of debt burden. According to the CSLP, the “cost to the federal government for student loans in bankruptcy, has vaulted from \$30 million in 1990-91 to \$70 million in 1996-97.”³²

III. WHY DO STUDENTS DEFAULT?

Proposed causes of student loan default, according to a review of the literature, seem to fall into three general categories: (1) the defaulters' inability to pay; (2) the imperfect knowledge, or negative attitudes, of some borrowers; and (3) the incentives for default created by the program rules.

The evidence suggests that inability to pay is the most important cause of default. This conclusion is based primarily on a number of empirical studies that have demonstrated the strong relationship between unemployment and low earnings on the one hand, and student

³⁰ See *Student Loans in Canada*, *supra* note 19 at 17.

³¹ See J.W. Brighton & J.A. Connidis, *Consumer Bankrupts in Canada* (Ottawa: Consumer and Corporate Affairs Canada, 1982).

³² *Ensuring Opportunities* *supra* note 26, online: Human Resources Development Canada <http://www.hrdc-drhc.gc.ca/student_loans/postgraph/va9_e.html#300> (date accessed: 16 August 1999).

loan default on the other. I now briefly review the literature on each of the three categories.

A. Borrowers' Inability to Pay

Since higher education is a risky investment, some former students may end up working at jobs that pay no more than the jobs they might have held without a post-secondary education. Some former students are unable to find a job at all. These financial "losers" include disproportionate numbers of those who dropped out without finishing a degree, those who graduated without skills that were saleable in the labour market, and those who were simply unlucky, never managing to find steady and remunerative employment after leaving full-time studies. These borrowers might be considered "can't pay" defaulters, as opposed to "won't pay" defaulters, who default because of their unwillingness to repay.³³

What proportion of defaulters fall into the "can't pay" category? Some evidence on this point is available from several academic studies of default in the American Guaranteed Student Loan program, which operated much like the CSLP did before the introduction of "risk-sharing" in 1995. These studies exploit the National Postsecondary Student Aid Study (NPSAS),³⁴ which is a source of excellent data for studying default. The NPSAS data contain (1) a variable indicating whether individuals defaulted on their student loans; (2) a measure of individual post-schooling earnings; (3) a set of variables capturing other characteristics of the borrower; and (4) a set of variables that characterize the borrower's educational institution.

If all defaulters were simply unwilling to repay their loans even though they had the means to do so, then post-education earnings would be uncorrelated with default. High-earning former students would be just as likely to default as low-earning former students. If the opposite were true—if all defaulters were willing to repay, but simply lacked the

³³ This often-heard distinction between "can't pay" and "won't pay" defaulters reflects one of the implicit moral judgements that accompany the policy debate about student loan default. It implies a clear distinction between one group of honest, but unfortunate defaulters, and a second group who knowingly abuse the system in order to avoid repayment. However, this distinction can be quite blurry. Even an honest but unfortunate borrower, faced with severe financial difficulty, must decide which payments must be made and which can be put off. Depending on the specific circumstances, student loan repayment may not be at the top of the list for all borrowers.

³⁴ For an overview of the NPSAS, see online: National Postsecondary Student Aid Study <<http://nces.ed.gov/npsas/overview.asp>> (date accessed: 11 September 1999).

means to do so—then earnings would be the decisive factor in determining whether or not a borrower defaulted.

The studies based on the American data are quite clear. The level of earnings is a statistically significant and substantively important correlate of default. Those with low earnings are more likely to default than those with high earnings. Mark Dynarski wrote that “earnings ... [have a] major [impact] on the likelihood of defaulting.”³⁵ He estimated that a 1 per cent decline in earnings would lead to a 0.3 per cent increase in the probability of default.³⁶ J. Fredericks Volkwein and Bruce Szelest wrote that “significant decreases in default probability are produced by ... current earnings.”³⁷ When the NPSAS directly asked defaulters why they had defaulted, 73 per cent responded that they were “unemployed and without income.”³⁸

As part of its recent evaluation of the CSLP,³⁹ Human Resources Development Canada (HRDC) asked Goss Gilroy Inc. to survey a group of CSLP borrowers.⁴⁰ Using that survey, I found that earnings were even more important in the Canadian context than in the American. Among Canadian borrowers, a 1 per cent decline in earnings was estimated to lead to a 0.8 per cent increase in the probability of default.⁴¹

Further evidence on this point comes from the final report of the committee reviewing the British Columbia Student Assistance Program, which stated that “[t]he Ministry of Finance’s Loan Administration Branch estimates that 30 per cent of student loan defaulters are able but unwilling to pay. This leaves 70 per cent who are willing to pay but whose circumstances are such that they cannot make the required payments.”⁴²

³⁵ “Who Defaults on Student Loans?,” *supra* note 19 at 66.

³⁶ *Ibid.*

³⁷ Volkwein & Szelest, *supra* note 19 at 57. In a second model estimated by Volkwein and Szelest, current earnings seemed to have no effect on the probability of default (though other variables related to earnings did affect default).

³⁸ “Who Defaults on Student Loans?,” *supra* note 19 at 63.

³⁹ See *Evaluation: Final Report* *supra* note 1.

⁴⁰ See Human Resources Development Canada, *The Survey of Borrowers* (1997) [unpublished].

⁴¹ See S. Schwartz, “The Determinants of Default on Loans From the Canada Student Loans Program” (1997) [unpublished, on file with author] [hereinafter *Determinants of Default*]. This report was part of an evaluation of the Canada Student Loan Program conducted by Goss Gilroy Inc. on behalf of HRDC: see *Evaluation: Final Report* *supra* note 1.

⁴² British Columbia, *Review of B.C. Student Assistance and Barriers to Post-Secondary Participation: Final Report* (Victoria: Ministry of Advanced Education, Training and Technology, 1992) at 32 [hereinafter *Review of B.C. Student Assistance*]. Some loans fall into default because the

In 1990, the auditor general wrote that 44 per cent of defaulters who were contacted refused to cooperate, perhaps reflecting an unwillingness to repay.⁴³ However, the dichotomy of “cooperate” versus “refuse to cooperate” is not the same as “able to pay” and “unable to pay.”

B. *Knowledge and Attitudes*

Despite this clear result suggesting that many students default because they cannot repay their loans, post-education earnings were not the *only* correlate of default in any of the empirical studies. Two other factors seem to be that borrowers are either confused about their repayment obligations or that borrowers simply refuse to repay. Many students are relatively young and, therefore, without long experience in credit relationships. Their knowledge about student financial assistance seems to be quite limited. In British Columbia, “[a] 1991 survey of 3,500 high school completers and first year post-secondary students reported that approximately half of the participants were dissatisfied with their knowledge of student financial assistance.”⁴⁴

Some of the borrowers’ confusion about student borrowing may be related to the nature and circumstances in which it occurs. The process of applying for, and receiving, student financial assistance is closely linked with the process of attending school, rather than being a separate and discrete activity. Unlike consumer loans, student loans are not tied directly to the purchase of tangible consumer goods and no repayment is demanded until the end of full-time studies. Indeed, there is little contact with the lender for potentially long periods while the student is engaged in full-time studies.⁴⁵ As a result, some students may not even know (or may not remember) that part of their financial aid package was, in fact, a loan that must be repaid.

According to what little has been written on this subject, many students are unaware of the details of their borrowing, and some students are even unaware that they *are* borrowing. As Judy Dyck wrote:

lenders have not been able to locate borrowers after they have left full-time studies (and because those same borrowers either neglected to contact their lenders or did not know that this was required). The estimate that 70 per cent of defaulters are in the “can’t pay” category would seem to include defaulters whose willingness to repay is unknown.

⁴³ See *Report of the Auditor General* *supra* note 29 at 702.

⁴⁴ *Review of B.C. Student Assistance*, *supra* note 42 at 37.

⁴⁵ Students have contact with their lenders only when they file a form indicating that they are continuing their studies (and are still eligible for the interest subsidy), or if they apply for another loan.

Individual students have little awareness of the niceties of federal/provincial jurisdictions and the extent to which they are being affected by federal regulations, provincial regulations, or by provincial interpretations of federal regulations. They respond to the adequacy of the total "aid package" in meeting their needs, and whether that package is delivered to them in an effective manner.⁴⁶

The transition into loan repayment may also be mysterious to students. After leaving school, borrowers must make arrangements with the lenders to consolidate their loans and to begin repayment. Many borrowers never make such arrangements and quickly fall into default. The University of Alberta Students' Union wrote that "[l]ittle information is provided to students regarding the consolidation process. In fact, [most] students only realize the commitment and what exactly the repayment structure means [when] they are consolidating [their] loans."⁴⁷

Another common perception is that borrower attitudes are related to student loan default. Despite that perception, there has been no systematic study of borrower attitudes toward student loan default.

C. Incentives for Default Created by Program Rules

Lending under the CSLP involves a complicated partnership among the federal government, the provincial governments, post-secondary schools, and the lending institutions. This situation is in stark contrast to the simpler relationship between private borrowers and lenders. The complexity of the CSLP partnership, as it evolved in the thirty years prior to the 1995 risk-sharing agreement, resulted in a long list of program rules that govern the rights and obligations of each of the parties to the loan.

Four kinds of rules were potentially important in affecting default rates: (1) eligibility rules that determined how much students are allowed to borrow; (2) rules determining the diligence with which banks sought repayment; (3) rules influencing the extent to which banks allowed flexibility in repayment; and (4) rules that specify the consequences of default for the defaulting students.

⁴⁶ J. Dyck, *Consequences of Increased Student Borrowing and Implications for Public Policy on Higher Education*(M.Ed. Thesis, University of Manitoba, 1995) at 62 [unpublished].

⁴⁷ University of Alberta Students' Union, *Making Ends Meet: Student Finances at the University of Alberta: A Submission to the Senate Task Force on Student Finance*(Edmonton: University of Alberta Students' Union, 1992) at 13.

1. Eligibility rules

For CSLP loans, the rules determining eligibility are set by the federal government in consultation with provincial governments, and are based on students' assessed need (the difference between estimated resources and anticipated costs) rather than any potential "ability to repay." In fact, part of the rationale for government intervention is that many students who might benefit from higher education lack earnings and assets—and consequently cannot demonstrate an "ability to repay." Making loans to such young people fosters equality of opportunity.

However, the policy of lending without regard to ability to repay is likely the root cause of at least some defaulted loans. The large loans that represent "equal opportunity" to some are evidence of "lender irresponsibility" to others. Where a private lender might be driven out of business by a policy of lending large amounts of money to individuals who can show no ability to repay, a government may be able to pass on any resulting losses to its taxpayers.

2. Due diligence rules

Under the terms of the federal government's guarantee of CSLP loans issued before August 1995, banks could make a claim for reimbursement if its efforts to collect on the loan were unsuccessful. There were, however, rules defining the "due diligence" required of the lenders before a default claim would be approved. Due diligence required that banks try to find delinquent borrowers before filing a default claim. However, the bank needed only to send registered letters to the borrower's last known address. If there was no response to these letters, the bank could ask the government to make good on its guarantee, sending the borrower into default.

The certainty of the government guarantee, combined with the relatively small size of student loans and the below-market interest rates they carried, would seem to have diminished the banks' enthusiasm for pursuing delinquent borrowers. The auditor general was quite damning in this regard: "Our audit found that, in the majority of cases, banks have made little effort to encourage repayment by students."⁴⁸

⁴⁸ *Report of the Auditor General* *supra* note 29 at 701.

Some evidence of the importance of the due diligence rule comes from the 1997 evaluation of the CSLP.⁴⁹ Since the name of the lender was known, it could be determined if default rates varied across lenders, holding constant the characteristics of the borrowers. It was found that “despite the similarity in [the] borrower profiles, borrowers who used one particular lender ... had higher probabilities of default.”⁵⁰ Thus, it is possible that lenders varied in their inclination to file claims for loss.

3. Lack of flexible repayment plans

Prior to the recent reforms, the repayment terms of a CSLP loan required fixed monthly payments for a maximum of 114 months. However, according to the report of the Ministerial Task Force on Youth, a young university graduate might now take up to two years before settling into a career-track job linked to the graduate’s education and interests.⁵¹ For those who have outstanding student loans, the combination of an unsteady income and an inflexible monthly loan payment created the potential for default.

The committee reviewing the British Columbia Student Assistance Program wrote:

Unemployment and underemployment make it difficult for many to meet the inflexible payment provisions of the Canada and B.C. Student Loan Programs. Many in-person and written submissions to the committee came from students wanting to meet their obligations but feeling forced into default—some into personal bankruptcy—by the size of their student loans and the repayment requirements.⁵²

4. Consequences of default

If students suffered financial hardship after defaulting upon their student loan, it might conceivably deter other borrowers from going into default. Alternatively, if the consequences of default were minimal—if

⁴⁹ See *Evaluation: Final Report* *supra* note 1.

⁵⁰ *Determinants of Defaults* *supra* note 41 at 16.

⁵¹ See Human Resources Development Canada, Ministerial Task Force on Youth, *Take On the Future: Canadian Youth in the World of Work, Report—Ministerial Task Force on Youth* (Ottawa: Human Resources Development Canada, 1996) at 4.

⁵² *Review of B.C. Student Assistance* *supra* note 42 at 32.

borrowers could “get away” without repaying their student loan—future defaults might be encouraged.

Defaulted loans were typically turned over to commercial collection agencies, which then tried to track down the borrowers and establish a repayment schedule. Sometimes the collection agencies needed only minimal efforts to find the borrowers. Once found, some borrowers were more than willing to begin repayment. In other cases, borrowers could not be found without greater efforts than the collection agency (and CSLP) thought economically warranted. In still other cases, borrowers were located, but either refused or were unable to repay.

Aside from the unpleasantness of being the target of sometimes aggressive collection efforts, borrowers did not suffer greatly as a consequence of default. Before 1991, the fact that a borrower had defaulted on his or her student loan was not reported to any of the commercial credit bureaus that determine the “credit rating” for potential borrowers. As a result, other borrowing by defaulters was simply not affected by their student loan default.

IV. THE SITUATION OF BANKRUPTS WITH STUDENT LOANS AMONG THEIR DEBTS

In 1997, the Office of Consumer Affairs of Industry Canada commissioned a survey of over 1,000 debtors who sought bankruptcy protection between mid-March and early May of that year.⁵³ The survey responses were then combined with information contained in the Statement of Affairs, an official form summarizing the financial position of the debtors. The research project was intended to help understand the causes of consumer insolvency in Canada.

For this article, I use the resulting survey data to compare the economic status of the bankrupts who have student loans among their debts to that of the overall sample. Two sub-groups of student loan borrowers can be defined in the survey: (1) the group of 262 individuals who had student loans among the liabilities listed on their Statements of Affairs; and (2) the group of 183 individuals who either said that student loans “triggered” their bankruptcy, or who had student loan liabilities whose dollar value was more than 50 per cent of their total debt.

In the discussion that follows, these two groups are compared to the complete sample of potential bankrupts and, where possible, to the entire Canadian population. The picture that emerges is unequivocal. As

⁵³ See *Empirical Study*, *supra* note 2.

a group, bankrupts who are also student loan borrowers are in worse economic shape than the larger group of bankrupts. They are more likely to have very low household incomes and more likely to have depended on government transfers. They are not, in general, young professionals; many have no post-secondary credentials at all.⁵⁴

A. *Demographic Characteristics*

Since widespread student loan borrowing in Canada is largely a phenomenon of the 1990s, it is not surprising that those with student loans among their debts are quite a bit younger than other bankrupts. More than one-half (57.3 per cent) of those with student loans among their debts were under thirty, as opposed to only 32 per cent of all bankrupts. Those whose student loans were critical to their bankruptcy were younger—62.8 per cent were under thirty.⁵⁵

Unlike other forms of credit, there are no obvious gender differences in student loan lending. Women are just as likely to go on to post-secondary education, and are just as likely to borrow from student loan programs. There are, however, gender differences in the ability of borrowers to repay student loans—differences that arise from the fact that women earn less, on average, than men, even when education is held constant. Thus, women end up with the same loan obligations but lower earnings. As a result, while 40 per cent of the full sample of bankrupts were women, over 60 per cent of those with student loans were women.

Given that student loans are made available only to individuals who enrol in designated post-secondary programs, it comes as no surprise that those with student loans among their liabilities are better educated than the overall group of survey respondents. Only 14.5 per cent reported a completed level of education of high school or less, compared to 47.2 per cent of the overall sample.⁵⁶ About 45 per cent had a post-secondary credential (split roughly equally between those

⁵⁴ One could argue that their economic situation might improve in the future—they are both younger and better educated than the overall group. However, there is no evidence of that future prosperity in their past history.

⁵⁵ These figures are based upon calculations from the *Survey of Potential Bankrupts* *supra* note 2.

⁵⁶ The figure of 14.5 per cent presumably represents those who did not complete the post-secondary program in which they enrolled.

with university and college degrees). The remaining 40 per cent reported having “some” post-secondary education but no completed degree.

The distribution of marital status of the overall group was quite different from the marital status of those with student loans. Those with student loans were much more likely to be single. In both groups, among those who were *not* single, there was a high proportion who were divorced or separated. Finally, the overall group was somewhat more likely to have dependants (including both children and dependant adults).

The socio-economic picture of those with student loans is of a group that contained more women, and was younger and better educated than the group of all bankrupts. Looking at these characteristics alone (apart from the relatively high proportion of “formerly married” individuals), the group with student loans looks much like any group of similar-aged Canadians. The similarity ends there, however, as an examination of their economic situation shows.

B. The Economic Situation of Bankrupts With Student Loan Debt

The survey asked respondents to state their pre-tax annual household income. Bankrupts with student loans had even lower incomes than the already low incomes of all bankrupts. Not surprisingly, the \$24,000 median income for all bankrupts was considerably lower than the median for all Canadians of \$37,130.⁵⁷ The median income for those with student loans among their debts was only \$14,000, while the median income for those whose student loans were critical to their bankruptcy was still lower, at \$12,000. Indeed, 80 per cent of the latter group had household incomes lower than the \$24,000 median of all bankrupts.

On their Statements of Affairs, bankrupts report their monthly income and expenses. As was the case with annual income, those with student loans were worse off than the group of all bankrupts. The median total monthly income of the full sample was \$1,400, while those with student loans had a median of \$1,200, and those whose student loans were critical to their bankruptcy had a median monthly income of only \$1,071.

⁵⁷ See S. Schwartz, “The Empirical Dimensions of Consumer Bankruptcy: Results From a Survey of Canadian Bankrupts” (1999) 37 *Osgoode Hall L.J.* 83 at 97, Table 3.

It may be useful to compare these median levels of monthly income to the eligibility thresholds⁵⁸ for the federal CSLP Interest Relief Program (IRP), which is available to CSLP borrowers with low incomes. The lowest Interest Relief monthly income threshold is \$1,472, and applies to a single person, living alone, whose monthly CSLP payment is less than \$25. The eligibility threshold is higher for those with larger families or larger CSLP payments. Two-thirds of those with student loans among their debts reported total monthly incomes of less than \$1,472; if family size and the size of CSLP loan payments could be factored in, that proportion would undoubtedly be much higher.

The Statement of Affairs contains the occupation of those seeking bankruptcy. If the person is not working for pay, that information is reported in the space provided for the occupation. For the majority of the sample, occupational information was therefore available, and can be compared to that reported for Canada as a whole.

Occupational information is often summarized by scales that attempt to measure “occupational prestige,” with “self-employed professionals,” “employed professionals,” and “high-level managers” at one extreme, and with unskilled workers near the other extreme. A common scale used with Canadian data is called the Pineo-Porter-McRoberts scale.⁵⁹ This scale has sixteen categories, ranging from self-employed professionals to farm labourers. For the purposes of this article, I have collapsed the upper three categories—self-employed and employed professionals, and high-level managers—into a category labelled “high prestige.” The lower three categories—unskilled clerical workers, unskilled manual labourers, and farm labourers—are collapsed into a single “low prestige” category. The remaining categories are combined into a “medium prestige” category.

In the full survey sample, 33.4 per cent were in the low prestige category (see Table 1, below). Despite their greater education, those with student loans among their liabilities, and those whose student loans were critical to their bankruptcy, had even higher proportions in unskilled occupations (37.6 per cent and 34.8 per cent, respectively) than either the Canadian population or the group of all bankrupts.

In the full sample, 4.7 per cent were employed in occupations at the top of the occupational prestige scale. In the two groups with student

⁵⁸ See *Canada Student Financial Assistance Regulations* S.O.R./95-329, Sch. I [hereinafter *CSFA Regulation*].

⁵⁹ See P.C. Pineo, J. Porter & H.A. McRoberts, “The 1971 Census and the Socioeconomic Classification of Occupations” (1977) 14 *Can. Rev. Soc. & Anth.* 91.

loans, the proportions employed in these more prestigious occupations were higher, at 6.8 and 7.6 per cent, respectively.

TABLE 1
OCCUPATIONAL PRESTIGE OF DEBTORS
FILING FOR BANKRUPTCY

<i>Occupational Prestige Category</i>	<i>All Canadians (%)</i>	<i>Full Survey Sample (%)</i>	<i>Those With Student Loans Among Debts (%)</i>	<i>Those Whose Student Loans Were Critical (%)</i>
High Prestige	12.5	4.7	6.8	7.6
Medium Prestige	66.5	66.8	62.4	57.7
Low Prestige	21.1	33.4	37.6	34.8

One of the striking findings by myself and Leigh Anderson⁶⁰ was the extent to which those seeking personal bankruptcy had been reliant on government transfers at some point in the two years prior to filing for bankruptcy. As Table 2, below, shows, 27.1 per cent had received income assistance within the two previous years. Those numbers are even higher for the sub-group that had student loans. More than 40 per cent of those with student loans had been on income assistance within the past two years—41.2 per cent for those with student loans among their debts, and 44.8 per cent for those whose student loans were critical to their bankruptcy. In addition, about 30 per cent of all three groups had received unemployment insurance benefits.⁶¹ In the full sample, 47.6 per cent had received either income assistance or unemployment benefits. The corresponding percentages for the two groups of student loan borrowers were 56.5 per cent and 61.7 per cent, respectively.

We might consider participation in these programs as an independent indication of economic difficulty. Another such indicator is whether the person had sought further credit and had been turned down, presumably because the lender felt that the potential borrower lacked the ability to repay a new loan. Almost one-third of the full sample had been turned down for credit within the past two years (see Table 2); a slightly higher proportion of those with student loans had been turned down for further credit.

⁶⁰ See *Empirical Study*, *supra* note 2.

⁶¹ The federal Unemployment Insurance (UI) program is now known as the Employment Insurance (EI) program.

TABLE 2
OTHER INDICATORS OF ECONOMIC DIFFICULTY
WITHIN THE PAST TWO YEARS

	<i>Full Survey Sample (%)</i>	<i>Those With Student Loans Among Debts (%)</i>	<i>Those Whose Student Loans Were Critical (%)</i>
Per Cent Receiving Income Assistance (IA)	27.1	41.2	44.8
Per Cent Receiving Unemployment Insurance (UI)	30.3	29.8	32.2
Per Cent Receiving Either IA or UI	47.6	56.5	61.7
Per Cent Turned Down For Credit	31.8	35.5	38.3

C. Summary

The economic situation of all those declaring bankruptcy suggests that bankruptcy is used primarily as a last resort. The economic situation of those seeking bankruptcy protection with student loans among their debts, or whose student loans were critical in their bankruptcy, is even worse than the already desperate situation of the whole group. To be sure, they are younger and have more education, but they have lower annual household income and lower monthly income at the time of filing for bankruptcy. More than 40 per cent had received income assistance in the two years previous to filing, and about 30 per cent had received unemployment insurance. A surprisingly large proportion—more than one-third—had occupations that were unskilled.

**V. RECENT LEGISLATIVE CHANGES THAT RELATE
TO STUDENT LOAN BORROWERS**

Recent legislation has introduced a number of changes to the process by which student loans are repaid. Of most interest—and most

surprising to those involved with personal bankruptcy—was the provision in the 1998 federal budget that announced the government’s intention to make student loans non-dischargeable for a period of ten years after the completion of full-time studies.⁶² Just a few months earlier, and after a long series of consultations, a series of amendments to the *Bankruptcy and Insolvency Act* (*BIA*) had been passed by Parliament.⁶³ One of the amendments introduced a two-year “waiting period,” following the end of full-time studies, during which student loans could not be discharged.⁶⁴

The unanticipated introduction of a ten-year waiting period, so soon after the introduction of the two-year waiting period, led to protests by insolvency professionals—represented by the Canadian Bar Association (CBA) and the Canadian Insolvency Practitioners Association (CIPA)—who felt that the results of the lengthy consultations had been unwisely disregarded. Why might the government have implemented this new ten-year waiting period? No answer to this question has been made public, but some speculation may be in order.

First, the ten-year waiting period, if it does nothing else, will bring an end to stories of young professionals, just out of school, brazenly declaring bankruptcy in order to have their student loans discharged. It may not have mattered that the number of such cases was extremely small, or that judges had the discretion to order only conditional discharge of student loan debt.⁶⁵

Second, other changes to the CSLP loan repayment programs, discussed below, were introduced at the same time. These changes seem to have been intended to create a situation in which bankruptcy was

⁶² See *Budget Implementation Act, 1998* S.C. 1998, c. 21, s. 103 [hereinafter *Budget Implementation Act*], amending *Bankruptcy and Insolvency Act* R.S.C. 1985, c. B-3, s. 178 [hereinafter *BIA*].

⁶³ See *An Act to amend the Bankruptcy and Insolvency Act, the Companies’ Creditors Arrangement Act and the Income Tax Act* S.C. 1997, c. 12.

⁶⁴ *Ibid.* s. 105(2). The arguments for making student loans non-dischargeable are rarely stated explicitly. Some have argued, presumably against discharge, that student loans finance an investment in human capital that cannot be repossessed. Another argument is that the discharge of student loans leads to a loss of public funds and, for that reason, should not be lightly granted. Lurking in the background is the undocumented assertion that some student loan borrowers—perhaps young lawyers, accountants, doctors, and dentists—are abusing the *BIA* by seeking the discharge of their student loans just after leaving school, and before their earnings have risen to what they will later be.

⁶⁵ In most consumer bankruptcy cases, a bankruptcy judge decides, nine months after the debtor has filed for bankruptcy, whether or not to grant a full discharge of debts. In the case of student loan debt, it was not uncommon for judges to require that debtors pay a percentage of the debt as a condition for the discharge of other debts.

unnecessary for those with student loans—to be sure, if a potential bankrupt's only debts were CSLP loans, bankruptcy would rarely be necessary. It is, however, unusual to find debtors whose only debts are to the CSLP.⁶⁶ Other debtors, as the CBA and CIPA representatives pointed out in their Senate testimony, may simply be forced to return to the bankruptcy court, ten years after a first bankruptcy, seeking to have the remaining balances on their student loans—both federal and provincial—discharged.

For a number of reasons, the possibility of saving public funds was probably not a major consideration. The financial cost of the other changes will far exceed the value of the student debt that would have been discharged through bankruptcy. As well, just because student loan debt now survives bankruptcy does not mean that the loans will be repaid. Moreover, in the wake of the risk-sharing agreements of the early 1990s, loan losses are not, by and large, borne by government. As such, it is the lenders who would benefit from these hypothetically greater loan repayments, not the public coffers.

Regardless of the government's rationale for introducing the ten-year waiting period, the empirical evidence presented above suggests that most of those seeking bankruptcy protection with student loans among their debts have very low incomes and no guarantee of higher future incomes. Waiting ten years is not only unlikely to change their economic situation, but will deny them the "fresh start" that is one of the aims of the *BIA*. In my view, a waiting period, whether of two or ten years, is neither necessary nor desirable.

The waiting periods also violate one of the principles that have guided the *BIA* reform process, on-going since 1992. As the CBA and CIPA representatives made clear, great efforts had been made to reduce the extent to which any one kind of creditor received special treatment under the *BIA*. By creating special provisions for student loans owed to commercial banks and governments, the 1998 changes move away from this goal.

Supposing that deletion of the waiting period from the *BIA* is not in the cards, one way forward is to push for the introduction of a "hardship" clause that would allow judges to shorten the ten-year

⁶⁶ Among the 1,018 debtors in the *Survey of Potential Bankrupts*, *supra* note 2, 14 had only student loan debts: see *Empirical Study*, *supra* note 2. The federal-provincial composition of the debts cannot be determined from the Statements of Affairs, so we do not know if any of the 14 debtors had only CSLP loans.

waiting period if the borrower is experiencing substantial hardship.⁶⁷ There is even a natural starting point for defining “substantial hardship”: that the borrower has participated in the CSLP Interest Relief Program (IRP), but still shows no signs of being able to repay.

The lengthening of the period during which student loans would be non-dischargeable was only one of a number of changes, most of which were aimed at lightening the burden of student loan repayment by providing more relief to those with low incomes. These included (1) expanding the range of borrowers eligible for the IRP and increasing the amount of relief available; (2) providing for a measure of loan forgiveness to CSLP borrowers who exhaust their eligibility for interest relief and who still have difficulty making payments; (3) creating federal tax credits for interest paid on both federal and provincial student loans; and (4) establishing two new grant programs.

Two features of the Canadian student loan system should be kept in mind as these changes are discussed. The first is that there are two kinds of student loans: loans made as part of the CSLP, and loans made under provincial student loans programs. Most student loan borrowers have loans from both federal and provincial programs, but the changes to the IRP and the introduction of loan forgiveness apply only to CSLP loans and not to provincial loans. The provincial loan programs have their own debt relief programs, which tend to involve loan forgiveness more than interest relief.⁶⁸

Second, CSLP loans made after August 1995 are largely the responsibility of the private banks, which had accepted a 5 per cent “risk premium” in return for bearing the responsibility of debt collection. Several provincial loan programs have also negotiated “risk-sharing” agreements similar to that of the CSLP. The provision of publicly-funded interest relief to student loan borrowers (and the extension of non-

⁶⁷ Such a clause already exists in the American bankruptcy process. There, no discharge of student loans is allowed within seven years of the end of studies unless the borrower can demonstrate substantial hardship.

⁶⁸ On-going federal-provincial negotiations are aimed at creating a single, combined federal and provincial loan program. In the spring of 1999, the federal government and the governments of Ontario and New Brunswick signed agreements that foresee a “Harmonized Student Loan” program in place for the 2000-2001 academic year. The agreement “creates a single loan, and streamlines administration for loans in a manner that simplifies financial assistance for student borrowers”: see Human Resources Development Canada, News Release 99-44, “The Government of Canada and the Government of Ontario Harmonize Student Loans” (4 May 1999); and Human Resources Development Canada, News Release 99-43 “The Government of Canada and the Government of New Brunswick Harmonize Student Loans” (4 May 1999). Under those agreements, interest relief will be extended to all student loan borrowers, and loan forgiveness (called “debt reduction in repayment”) will be considered in some circumstances.

dischargeability from two to ten years) may give substantial benefits to student loan lenders, rather than to the government.⁶⁹

A. *Changes to the CSLP Interest Relief Program
and "Debt Reduction" for CSLP Loans*

While student loan borrowers are in school, the federal government pays the interest on their CSLP loans. As soon as the student leaves school, the interest subsidy stops and interest begins to accumulate. Upon leaving school, however, borrowers are allowed a six-month grace period during which no repayments are required.

The IRP is available to borrowers who are trying to pay back their CSLP loans and who have low income.⁷⁰ Initially, borrowers are eligible for three months of interest relief; borrowers must apply for additional three-month extensions as necessary. While on interest relief, borrowers make no debt payments; when their eligibility for the program comes to an end, the amount of principal owed is unchanged from when they entered. Since 1995, the IRP has been managed by the private lenders on behalf of the government, as part of the "risk-sharing" agreement described above.

Historically, the IRP has not been widely used. In the 1997 Goss Gilroy survey of student loan defaulters, only one-third of them had even heard of the program.⁷¹ Now that the program is managed by lenders who have no government guarantee of repayment, the use of the IRP is expected to become much more widespread.

Prior to the 1998 changes, the IRP was available to eligible CSLP borrowers for up to thirty months within the first five years of repayment.⁷² The *Budget Implementation Act* of 1998 repealed the provision that restricted the availability of interest relief to the first five

⁶⁹ Several caveats apply to that general statement. Some provincial loans are still guaranteed by the provincial governments so that the provincial government is being given special consideration. In the same way, the private banks can "give back" a small proportion of bad CSLP loans to the federal government, which then becomes the creditor.

⁷⁰ The definition of "low income" depends on both the monthly repayments due on the CSLP loans and on family size.

⁷¹ See *Evaluation: Final Study*, *supra* note 1.

⁷² See *CSFA Regulations* *supra* note 58, s. 20(2).

years of the repayment period,⁷³ which typically lasts for ten years after the borrower leaves school. The IRP is now available over the entire repayment period.⁷⁴ If borrowers exhaust the thirty months of interest relief and are still not in a position to repay their loans, interest relief can now be extended for up to another twenty-four months.⁷⁵

In addition, starting in April 1997, the eligibility-defining income thresholds were increased by 9 per cent, making more borrowers eligible. For those with income below the now higher thresholds, partial interest relief will be introduced in 1999. Depending on income, the CSLP will pay 75 per cent, 50 per cent, or 25 per cent of the interest.

The overall impact of these changes, in theory, is to make the IRP more generous. The monthly dollar outlay for CSLP loan repayments should be more sensitive to the borrower's income. The practical impact of the changes depends on how they are implemented and on whether borrowers avail themselves of the program.

Several provinces—most notably Ontario—have student loan forgiveness programs. If the amount borrowed exceeds a certain level, the portion in excess of that level is forgiven. In Ontario, as of 1999, any amount borrowed before the 1998-1999 academic year from the CSLP and the Ontario loan program totalling over \$7,000 in any one year is forgiven if the borrower applies to the debt remission program.⁷⁶

Effective on 1 August 1998, the CSLP introduced a measure of loan forgiveness known as “debt reduction in repayment.” If a borrower has exhausted all the aid available from the IRP, and if the payments due on the CSLP loans exceed 15 per cent of income, then part of their CSLP loan—the smaller of \$10,000 or 50 per cent of the principal—can be forgiven.

These changes to the IRP, and the introduction of a measure of loan forgiveness, have the welcome effect of introducing a larger

⁷³ See *Budget Implementation Act* supra note 62, s. 99, repealing *Canada Student Financial Assistance Act*, R.S.C. 1985, c. S-23, s. 9; and *Regulations Amending the Canada Student Financial Assistance Regulations* S.O.R./98-402, s. 3(3) [hereinafter *CSFA Regulations Amendment*]; repealing *CSFA Regulations* supra note 58, s. 20(3).

⁷⁴ See *CSFA Regulations Amendment* supra note 73, s. 3.

⁷⁵ Another of the 1998 changes was that lenders may be asked to extend the repayment period—from ten to fifteen years—for borrowers participating in the IRP who are experiencing severe difficulty in repayment. This would have the effect of reducing monthly student loan payments (although increasing the total amount paid). It is unclear, at this point, how this provision will be implemented.

⁷⁶ See Ministry of Education and Training, “Ontario Student Opportunity Grant” in *OSAP: Ontario Student Assistance Program Application and Guide for Full-time Students 1999-2000* (Toronto: Queen's Printer, 1999) 17.

measure of income sensitivity to the student loan repayment process. That income sensitivity acknowledges the importance of low earnings in creating problems for those in repayment.

At least theoretically, the institution of a student loan system in which repayment is fully income contingent (as are the student loan systems in Australia and New Zealand) would have been even more welcome. However, such a change—once proposed as part of former Minister of Human Resources Development Lloyd Axworthy's package of social security reforms—seems politically impossible, given widespread student opposition, the lack of provincial enthusiasm, and the 1995 introduction of "risk-sharing" by the CSLP. In that context, the 1998 changes to the IRP and the federal loan forgiveness measures may have been the only feasible steps in the direction of income-contingent loan repayment.

Despite the increased income sensitivity of the CSLP programs, however, there will still be borrowers who are unable to repay their student loans. Some will be borrowers who have loans from provincial programs that are not covered by CSLP interest relief. Others will be borrowers who exhaust their five years of interest relief eligibility and have their debts reduced, but who are still unable to pay the remaining outstanding balances. If economic growth continues, these borrowers may be few in number; if not, more loans may have to be forgiven.

B. Tax Credits for All Student Loan Borrowers

The only new provision that applies to all student loans, as opposed only to CSLP loans, is that all borrowers will be eligible for a federal tax credit, beginning in the 1998 tax year, on interest payments made on their federal and provincial student loans. As with all non-refundable tax credits, this credit will provide limited benefits to those most in need of help because those with low incomes will not have incomes high enough to benefit from the tax credit. Many of the borrowers who will take advantage of the new credit will have relatively little need for it because their loan repayment is not causing great hardship. Thus, the new tax credit has the opposite effect of traditional income-contingent repayment plans: those with higher incomes pay less because only they can take advantage of the tax credit.

The cost of the new provision is indirect—the tax revenues lost because of the tax credit might have been redirected to the minority who experience financial hardship. In particular, the eligibility thresholds for interest relief could have been increased by more than 9 per cent; more

than five years of eligibility could have been provided; and the level of debt reduction could have been increased. Still, having made the programs for borrowers with low incomes more generous, it is hard to criticize the government for providing what will certainly be politically popular aid to borrowers across the income spectrum.

C. New Grant Programs

One way to reduce the burden of student loan debt repayment is to reduce the need to borrow in the first place. In the 1998 federal budget, two new grant programs were created that will presumably reduce some students' need to borrow.

Canada Study Grants (that incorporate the grants known as Special Opportunity Grants) will operate under the aegis of the CSLP and provide up to \$3,000 per year to about 25,000 students with dependant children. The amount of the grant will depend on financial need demonstrated through the standard needs-analysis procedures. These grants will be available beginning in August 1998. The second new grant program, called Canada Millennium Scholarships, will operate through a separate foundation and will grant up to \$3,000 to about 100,000 students.

These new grant programs are quite welcome, since they will reduce the need of some low-income students to borrow and, thus, reduce the later burden of debt repayment for them.

VI. CONCLUSION

Many students now leave school owing substantial amounts of money—money borrowed from financial institutions under rules specified by federal and provincial governments. Increased student loan borrowing began in the first half of the 1990s; as the borrowers leave school in the second half of the decade, the increased burden of repayment is becoming clearer.

Even among borrowers who are post-secondary graduates (as opposed to those who borrowed but did not complete their programs), the proportion of those reporting significant hardship in repaying their loans is fairly high (between 20–30 per cent of borrowers).⁷⁷ CSLP loan

⁷⁷ See *Student Loans in Canada*, *supra* note 19 at 46. See also note 20, *supra*, and accompanying text.

loss rates, prior to the 1995 decision to shift the default risk to lenders, were in the 10–12 per cent range.⁷⁸ The rise in the number and proportion of Canadians declaring bankruptcy with student loans among their debts was also a clear danger signal.

The overall thrust of recent legislative changes as they affected the student loan repayment process was quite positive because of the provision of increased income sensitivity. These changes acknowledged the empirical findings indicating that most student loan borrowers who have difficulty in repaying their loans fall into the “can’t pay” category, rather than the “won’t pay” category.

The creation of a waiting period during which student loans cannot be discharged through bankruptcy, however, was both unfortunate and unnecessary. The two-year waiting period introduced in the 1997 amendments to the *BIA* was bad enough, but the ten-year period introduced by the 1998 federal budget made the situation still worse. Former students in need of a fresh start will be denied it, and particular creditors—the banks that lend to students—will have been given an advantage denied to other creditors.

On-going negotiation may soon lead to the harmonization of the federal and provincial student loan programs. A harmonized program would certainly streamline the current set of confusing and overlapping loan programs. Hopefully, a harmonized program would adopt the income sensitive features that are currently embedded in both programs.

Also looming on the horizon is the renegotiation of the contract between the CSLP and the student loan lenders. Apparently, the lenders are asking for a large increase in the payments made to them by the CSLP in return for their assumption of most of the risk of loan default. The current arrangement already gives the banks substantial concessions, including a 5 per cent up-front payment, the ability to “give back” another 5 per cent of non-performing loans, a generous Interest Relief Program that pays interest to the banks when their borrowers cannot pay, and the ten-year waiting period before discharge of the debt through bankruptcy. As such, the CSLP would be wise to look askance at any request for even more generous terms.

⁷⁸ See *Student Loans in Canada*, *supra* note 19 at 17.