

Automatic Stay or Stop for Student Loans?



Addressing the clash is vital to ensure borrowers receive the financial relief they need.

BY IGOR ROITBURG, MANAGING DIRECTOR, STRETTO & SCOTT F. WATERMAN, ESQ.,
CHAPTER 13 TRUSTEE, EASTERN DISTRICT OF PENNSYLVANIA

Once a bankruptcy is filed, the Department of Education (DOE), its guaranty agencies and student loan servicers place debtors in administrative forbearance to ensure they do not run afoul of the automatic stay. While no collection actions are taken during the bankruptcy, interest on student loan debt continues to accrue, resulting in debtors owing more by the end of bankruptcy. Moreover, the administrative forbearance prevents debtors from enrolling in one of the DOE's income-driven-repayment plans (IDRs).¹

IDRs provide many benefits to student loan borrowers and are critical to a long-term solution. First, a debtor's payment is based on their family size and income (not loan amount and interest rate), so it is much more affordable. In fact, in some cases, the IDR payment can be \$0. Second, debtors on IDRs will ultimately have their loans forgiven after participating in an IDR for a given period of time.²

Recently, in an attempt to mitigate the impact of the automatic stay on loan forgiveness, the DOE introduced a

regulatory change (34 CFR § 685.209) set to take effect on July 1, 2024. Under these new rules, the DOE is supposed to award credit toward IDR forgiveness for months where the borrower makes payments under an approved bankruptcy plan.³ It is not clear how DOE and its servicers will implement this rule. In fact, in adopting this new rule, the DOE acknowledged that they will not know when a debtor made payments under an approved bankruptcy plan and will credit forgiveness "when [DOE is] notified that the borrower made the required payments...[DOE]

anticipate[s] that [DOE] will be informed about months of successful payments after the trustee distributes payments...[with DOE issuing credits] well after the payments to the trustee are made."⁴ DOE has signaled that it will accept a Chapter 13 Trustee's Final Report as evidence that a debtor made the payments. Those reports list the length of a case. However, it remains to be seen how DOE will treat debtors whose cases are dismissed prior to discharge. In any event, while this new regulation is a step in the right direction, it is hard to imagine how DOE and its servicers will be able to accurately track this information across the various bankruptcy districts—each with its own set of rules.

The solution seems to be to ensure that debtors enroll in IDRs and stay enrolled in IDRs during bankruptcy. In addition to making sure debtors get credit towards forgiveness during the bankruptcy, debtors will be able to take advantage of DOE's recently announced new IDR Plan—SAVE (Saving on a Valuable Education). The SAVE plan, which is available to nearly all borrowers, provides the lowest

monthly payments and most aggressive forgiveness schedule of any IDR plan to date. Most importantly, it includes an unpaid interest subsidy—i.e., if the debtor's monthly payment does not cover the monthly interest on the loan, the federal government will cover the unpaid interest. In other words, under SAVE, the loan balance will never increase.

This is in stark contrast to how student loans are typically treated in a bankruptcy. For example, a debtor with \$100,000 in loans at 7% will owe \$135,000 at the end of a 60-month Chapter 13 plan. If the same debtor were simply allowed to enroll in the SAVE plan while in the bankruptcy, they would accrue no interest, potentially saving up to \$35,000. In addition, by enrolling and remaining on SAVE during the bankruptcy (which requires annual recertification), the debtor will be better equipped to stay on SAVE and achieve loan forgiveness after the bankruptcy.

This, of course, brings us back to the original problem—how do debtors enroll in an IDR if they are in an administrative forbearance? This problem is not new. Debtors in bankruptcy have struggled to enroll in IDRs for a long time. Recognizing

the complexity of enrolling in IDRs during bankruptcy, several bankruptcy courts began implementing student loan management programs in 2019. These programs provide structure and transparency, allowing debtors to effectively enroll in IDRs without violating the automatic stay. As a prerequisite for entering into the program, debtors agree that communication with the DOE and its servicers is not a violation of the stay, allowing DOE to assist debtors without concerns about stay violations. It is a simple and effective solution in which every servicer is already participating.

For more than three years, borrowers received a reprieve from paying their federal student loans. No payments or interest were due. Today, these payments have resumed. Recent studies show that 45% of federal student loan borrowers expect to become delinquent on their loans and 53% already say they are struggling to pay other bills such as auto loans and credit cards.⁵ Many will undoubtedly turn to bankruptcy to help manage their debts.

Addressing the clash between automatic stays and student loans in bankruptcy is vital

to ensure that borrowers receive the financial relief they need. By combining regulatory changes, innovative IDR options like the SAVE plan, and the widespread implementation of student loan management programs, those invested in the process—including the courts, attorneys and the DOE—can provide better support to struggling borrowers and work toward resolving the growing student loan crisis. ■

FOOTNOTES

1. Debtor attorneys have been able to enroll clients in IDRs through the addition of language often referred to as the *Buchanan* provisions but as the DOE has noted "that option is infrequently used and confusing for borrowers." (See <https://www.federalregister.gov/documents/2023/07/10/2023-13112/improving-income-driven-repayment-for-the-william-d-for-d-federal-direct-loan-program-and-the-federal>)
2. Forgiveness can be achieved after 10-25 years on the IDR plan depending on the plan and amount and type of loans owed.
3. <https://www.federalregister.gov/documents/2023/07/10/2023-13112/improving-income-driven-repayment-for-the-william-d-for-d-federal-direct-loan-program-and-the-federal>
4. Id.
5. <https://www.creditkarma.com/about/commentary/federal-student-loan-borrowers-are-struggling-to-make-ends-meet-before-payments-resume-in-october>