

Pros And Cons Of Allowing Student Loan Bankruptcy Relief

By **Jeph Ledda and Lynda Bui** (December 11, 2019, 6:02 PM EST)

Student loan debt has become a growing focus of national debate, with more than 45 million student borrowers collectively owing approximately \$1.5 trillion.[1] Cumulatively, student loan debt has surpassed credit card debt and has become the second largest category of private consumer debt — only mortgage debt is higher.

Furthermore, student loan debt is the fastest growing segment of U.S. household debt, having increased by 157% since 2007.[2]

The Student Borrower Bankruptcy Relief Act of 2019 was introduced into Congress earlier this year. If passed, it would eliminate the Bankruptcy Code section that makes student loans nondischargeable.

While the course of this pending legislation remains uncertain, we can examine its potential impact, as well as its benefits and disadvantages as perceived by the law's proponents and critics. We can also take a historical perspective by looking back at past legislative attempts to regulate student bankruptcy filings in order to give context to the currently proposed legislation.

The intent of the proposed legislation is to enable student debtors to discharge federal and private student loans in the same way debtors can discharge other forms of consumer debt, such as credit card and mortgage debt. Specifically, it would amend Section 523(a) of Title 11 of the United States Code by striking paragraph 8, which excepts from discharge certain qualified student loans unless the borrower can show undue hardship on the debtor and debtor's dependent. Thus, student loans would be discharged like credit card debt.

Sponsored by U.S. Sens. Richard Durbin, D-Ill., and Elizabeth Warren, D-Mass., with U.S. Reps. Jerrold Nadler, D-N.Y., and John Katko, R-N.Y., its primary goal is to provide bankruptcy relief to students and families overwhelmed with the burden of student loan debt.

Previous legislative changes have progressively limited the dischargeability of student debt. The Bankruptcy Code of 1978 continued a previous rule that student loans could be discharged after five years or sooner if undue hardship could be proven. However, in 1982, the Brunner test[3] was established and became the most widely accepted standard to define undue hardship, which in turn



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made bankruptcy inaccessible to the majority of student borrowers.

The Brunner test is a three-part test with the following criteria:

- 1) The debtor cannot maintain, based on current income and expenses, a minimal standard of living for herself and her dependents if forced to repay the loans;
- 2) Additional circumstances exist indicating that this state of affairs is likely to persist for a significant portion of the repayment period of the student loans; and
- 3) The debtor has made good faith efforts to repay the loans.

In 1998, it became even more challenging for student borrowers to find relief when Congress eliminated the timeframe under which student loans could be dischargeable and made them nondischargeable unless undue hardship could be shown.

The Bankruptcy Abuse Prevention and Consumer Protection Act made all educational loans, both public and private, presumptively nondischargeable. Scholars expected the BAPCPA change would lower the cost of private loans and that more students would choose to attend college due to anticipated lower cost.[4]

This has not happened. Some have suggested that BAPCPA did not increase the availability of credit or lower the cost of student loans, but may have instead contributed to increased economic hardship by helping to boost enrollment in for-profit universities.[5]

Under the proposed Student Borrower Bankruptcy Relief Act, the bankruptcy community would see a significant impact on consumer bankruptcy filings. If passed, the act would likely increase bankruptcy filings among those who are eligible to discharge student loan debt.

The filers would likely be those students who borrowed from for-profit colleges (as opposed to traditional four-year universities) simply because statistics indicate that such group is more likely to fail to graduate and more likely to default on student loans in general. The other group could be parents who do not have monies, but became co-borrowers to assist their children.

In addition to increased filings, some say the legislation may help strengthen the overall economy given that student debt often constrains debtors' career and life choices, forcing debtors to take jobs that are not aligned to their career goals to pay back loans, and still without finding a way to get out from under their debt.

Trustees and debtors' attorneys who are well-versed in the legal aspects of student bankruptcy would likely see a surge of new cases, given the vast number of student borrowers who would be able to discharge student loans if the law were passed.

Clearly, there are two sides of the matter which have differing points of view. Those in favor assert that bankruptcy should be more accessible to rehabilitate any debtor in distress.

Student loan debt has caused distress to a rapidly increasing number of students even before they begin their careers. The pressures and financial discouragement to individuals when starting their careers can have a lasting impact for many years, and bankruptcy can give these individuals a fresh start.

Furthermore, students who drop out of college can be further disadvantaged with no education combined with the burden of student debt. Proponents assert that discharging their debt could enable them to pursue alternative careers without being saddled with debt from their unfulfilled college education.

On the other side, opponents of the Student Borrower Bankruptcy Relief Act are concerned that it would threaten the availability of subsidized student loans, for which interest does not start to accrue until after graduation from college. If these loans become dischargeable, they may be more challenging for students to secure. In turn, thousands, if not millions, of students would not be able to afford to go to college. This quagmire reminds us all that consumer protection comes at a price.

Given the rising cost of college, and in turn the daunting and exponential increase in student loan debt, there are no easy answers for student borrowers. However, the Student Borrower Bankruptcy Relief Act attempts to address how student borrowers can get out from under debt that has become an insurmountable obstacle.

Even if the bill does not pass, it has helped to raise awareness of the growing student loan crisis and how bankruptcy can serve as a means to offer student debtors a new beginning when their circumstances warrant it. This type of legislation is needed in order to make bankruptcy an accessible option, especially for those who may need relief from their student loan debt when faced with unforeseen circumstances. Revisions to the bankruptcy code could provide a much-needed solution for these student debtors and for future generations.

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[1] <https://www.thinkadvisor.com/2019/09/23/how-to-slow-the-student-debt-explosion/>.

[2] <https://www.latimes.com/business/la-fi-student-loan-debt-20181018-story.html>.

[3] Brunner v. N.Y. State Higher Educ. Serv. Corp., 831 F.2d 395, 396 (2d Cir. 1987).

[4] John A. E. Pottow, The Nondischargeability of Student Loans in Personal bankruptcy Proceedings: The Search for a Theory, 44 Canadian Bus. L. J. 245, 262 (2006)].

[5] Alexei Alexandrov & Dalié Jiménez, Lessons from Bankruptcy Reform in the Private Student Loan Market, 11 Harv. L. & Pol'y R. 175, 180-81 n.40, 201 (2017).