The Legal Intelligencer

A New Approach to Tackling Student Loans in Bankruptcy

By Igor Roitburg and Scott F. Waterman | June 30, 2022

While the road through Chapter 13 bankruptcy may be tenuous for student loan debtors, court-based student loan management programs provide all the elements that are needed for them to access and successfully navigate the existing federal student loan repayment options.

With student loans ranking as the second highest source of consumer debt in the United States, the federal government took significant measures starting at the onset of the COVID-19 economic crisis to protect student loan borrowers with loan repayment moratoriums. As these moratoriums are due to expire, many debtors will soon be faced with the challenge of how to repay and manage their debt. While bankruptcy traditionally has been seen as a challenging pathway for debtors with student loans, court-based student loan management programs have been adopted to facilitate the repayment and resolution of student loan debt within the chapter 13 bankruptcy process.

The Process Absent a Court Program

Typically, when a debtor with student loans files bankruptcy, they are often caught between the proverbial rock and hard place. It is nearly impossible to discharge student loan debt under the current bankruptcy legal standard. Under current bankruptcy law, debtors cannot discharge student loan debt unless they can show that the loan payment imposes an "undue hardship."

Generally, this means that debtors cannot maintain a minimal standard of living, the circumstances are unlikely to improve, and good faith efforts have been made to repay the loans.

Digging a Deeper Hole

Once a bankruptcy is filed, the Department of Education, its guaranty agencies and student loan servicers, place debtors in administrative forbearance to ensure they do not run afoul of the bankruptcy law and the protections it affords debtors from any and all creditors. As a result, while no collection actions are taken during the bankruptcy, interest on the student loan debt continues to accrue with the debtors often ending up owing more than they did to begin with. Hardly the "fresh start" bankruptcy is supposed to provide.

Adding insult to injury, the administrative forbearance prevents the debtor from enrolling in one of the nine by-right repayment plans that would normally be available to any federal student loan borrower if they were not in bankruptcy. These plans include repayment plans that enable the debtor to repay their loans based on their discretionary income and can be as low as $0. Repayment plans based on a borrower's income are known as "income-driven repayment plans" or "IDRs." IDR repayment amounts vary from 10%-20% of a borrower's discretionary income.

In addition, these repayments can earn the debtor credit toward forgiveness of their loans. There are multiple programs pursuant to which a borrower can have their loans cancelled or forgiven ranging from five to 25 years. There are even options for borrowers to get out of default. All of these by-right options are limited when the debtor is in bankruptcy.

The Benefit of Court Programs

Recognizing this conundrum and labyrinth of issues facing student loan debtors in bankruptcy, a number of bankruptcy courts have adopted student loan management programs. These programs provide structure and transparency for all parties—borrowers, attorneys, courts and loan servicers—to engage in a consensual resolution of the student loan debt more easily and efficiently. No additional options or rights are created for the debtor. They are simply able to review and enroll in the same by-right, repayment plans and options that they would otherwise have the right to do outside bankruptcy.

Using a secure, online, portal further facilitates the process. Debtor attorneys can determine which options best suit their client's needs and then submit the required federal applications directly to the servicer. The process starts with the debtor obtaining loan information directly from the government's website—studentaid.gov. The file, known as the NSLDS, is a student loan data file maintained by the Department of Education which contains all relevant information about the debtor's student loans including the type, amount and interest owed. The NSLDS can be downloaded in less than a minute and is the file-of-record containing the same information the government and its servicers use. The debtor's attorney then uploads the NSLDS file to the portal and answers a few basic questions about the debtor and their family and income. The portal then generates a comprehensive report detailing the options and repayment plans available to the debtor.

Once the debtor and counsel have had a chance to review and select the desired course of action, a complete set of application materials are prepared for the debtor which are then submitted electronically through the portal and processed by the servicer. All parties have access to the portal which enables real-time access and transparency for all involved.

As of this writing, four U.S. bankruptcy courts have already adopted such programs. A student loan management program was adopted in the U.S. Bankruptcy Court for the Eastern District of Pennsylvania with the goal of encouraging student loan resolutions between the lender and borrower. Attorneys with clients who participate in the program also receive a no-look fee of up to $1,500. There are also court-approved programs in the U.S. Bankruptcy Courts in the District of Vermont, Southern District of Florida and Middle District of Florida.

By accessing a student loan management program through Chapter 13 bankruptcy, debtors are able to repay their loans and work towards forgiveness while eliminating concerns from the trustee about payments. By reducing their monthly expenses, debtors have the ability to pay other unsecured creditors and work towards the "fresh start" that is intended from the bankruptcy process. In addition, debtor's counsel is reimbursed for their efforts.

While the road through Chapter 13 bankruptcy may be tenuous for student loan debtors, court-based student loan management programs provide all the elements that are needed for them to access and successfully navigate the existing federal student loan repayment options.

With greater adoption of these programs across the country, the student loan crisis and expiring moratoriums can be more efficiently mitigated, leading to improved outcomes and cost benefits for all involved.

Igor Roitburg *is the managing director of Stretto, a market-leading technology and bankruptcy-services firm and* Scott F. Waterman *is an attorney with an office in Media who works as a Chapter 13 trustee for the Eastern District of Pennsylvania.*

Reprinted with permission from the June 30, 2022 issue of The Legal Intelligencer.