



CLLA LEGISLATIVE DAY

October 4, 2022

THE STUDENT LOAN CRISIS

1. EVOLUTION OF DISCHARGEABILITY OF STUDENT LOANS

Over the last 45 years, the Bankruptcy Code has gone through a number of changes that have affected the dischargeability of student loans. Prior to 1976, student loans were no different than any other unsecured debt and were routinely discharged in bankruptcy proceedings. Due in part to concerns that student loan borrowers were abusing the bankruptcy process by discharging student loans, in 1976, Congress enacted the Education Amendments of 1976. The Amendment added Section 439A to the Higher Education Act of 1976 which permitted discharge under the Bankruptcy Act of an educational loan if the beginning of the repayment period, excluding any deferments, was more than five years before the date of discharge or sooner if the court determined that payment from future income or other wealth would cause an under hardship on the debtor or the debtor's dependents.

The Bankruptcy Act of 1978 added Section 523(a)(8) which adopted a modified version of the provisions in the Higher Education Act which included dischargeability of student loan debt in the Chapter 13 superdischarge. In 1990, the 5-year period was enlarged to 7 years and student loans were removed from the Chapter 13 superdischarge. In 1998, the 7-year exception was eliminated and a student loan could only be discharged upon a showing of undue hardship.

As a result of amendments to Section 523(a)(8) under the 2005 Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA), essentially all student loans, including private loans, became nondischargeable, barring a determination of undue hardship. Since the enactment of BAPCPA, many legislators have attempted to address the ever-increasing student loan debt by proposing bills the range from eliminating § 523(a)(8) in its entirety, to re-imposing provisions for a 5, 7 or 10 year unqualified discharge of student loans, to just eliminating discharge of private student loans.

During this evolution, the courts have also struggled with the various amendments to § 523(a)(8) and the interpretation of "undue hardship", which is not defined in the Bankruptcy Code. In 1987, the Second Circuit in *Brunner v. New York State Higher Educ. Servs. Corp.*, 831 F.2d 395 (2d Cir. 1987), devised a three-prong test to determine whether a debtor qualifies for an undue hardship exception. The test has been adopted by most of the Circuits and provides that a student loan may be discharged if:



1. The debtor cannot maintain, based on current income and expenses, a “minimal” standard of living for his/herself and his/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 loan(s); and
3. The debtor has made good faith efforts to repay the loans.

2. **THE PROBLEM**

Since the passage of BAPCPA in 2005, student loan debt has more than tripled from \$500 Billion in 2006 to over \$1.75 Trillion in 2022.¹ Although legislators have proposed a number of bills seeking to remedy this student loan crisis, no bankruptcy related laws have come close to passing. President Biden has recently implemented a plan to forgive certain student loan borrowers of up to \$20,000.00 of federal student loan debt, however, it does not address the need to fine tune and better defining “hardship” in § 523(a)(8) in order to create a more objective test to permit discharge of student loans in bankruptcy.

The *Brunner* test is dated, subjective, has been widely criticized by debtors as being overly strict and unfair, and imposes an enormous burden on debtors to prove its elements. More predictability is necessary in the area of student loan dischargeability.

3. **THE SOLUTION**

In 2019, a subcommittee comprised of CLLA Bankruptcy Section and Creditors’ Rights Section members, adopted a proposed amendment to § 523(a)(8) which more clearly defines the hardship required to be proven in order to discharge a student loan in bankruptcy. The CLLA proposal implements a standard of “substantial hardship”, which is met if:

1. The student loan obligation, first became due ten years prior to the filing of the bankruptcy case;
2. The debtor cannot maintain an adequate standard of living for the debtor and the debtor’s dependents if required to pay such debts; and
3. Such state of affairs is likely to persist for at least five years.

Further, substantial hardship is presumed if any of the following conditions are present:

1. The borrower:
 - (a) is receiving disability benefits under the Social Security Act,
 - (b) the borrower has either a 100% disability rating or has a determination of individual unemployability under the disability compensation program of the Department of Veterans Affairs,

¹ <https://www.federalreserve.gov/releases/g19/current/default.htm>



2. In the seven years before bankruptcy, the borrower's household income averaged less than 175% of the federal poverty guidelines, or
3. At the time of bankruptcy, the borrower's household income is less than 200% of the federal poverty guidelines and
 - (a) the borrower's only source of income is from Social Security benefits or a retirement fund; or
 - (b) the borrower provides support for an elderly, chronically ill, or disabled household member or member of the borrower's immediate family.

The CLLA proposal also allows for a discharge of student loans in Chapter 11, 12 or 13 cases if the debtor commits to paying 10% of the outstanding principal owing on the loan as of the petition date.

While other proposals focus on either eliminating Section 523(a)(8) altogether or limiting dischargeability to only private loans, the CLLA's proposal was reached through a compromise between its Bankruptcy and Creditors' Rights Sections and achieves the CLLA's key mission of fairness and equality. We believe that the CLLA proposal is a balanced, reasonable and definitive approach to addressing the student loan dilemma and one that should strongly be considered by Congress.