# Student Loan Options and Chapter 13 Bankruptcy

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# Obtaining Information About Federal Loans

Information about federal student can best be obtained from the National Student Loan Data System, which is the central database for student aid. It receives data from schools, agencies that guarantee loans, the Direct Loan Program, the Federal Pell Grant Program, and other United States Department of Education programs.

It is available online at:

https://www.nslds.ed.gov

# Differences Between Federal & Private Student Loans

| Statute of Limitations | |
|---|---|
| **Federal** | **Private** |
| There is no Statute of Limitations for Federal Student Loans. | Private Student Loans are subject to a Statute of Limitations.<br>This may be determined by the contract or by state law. |

# Differences Between Federal & Private Student Loans

| Debt Collection | |
|---|---|
| **Federal** | **Private** |
| The federal government and its debt collectors can collect through:<br>• Intercept Tax Refunds<br>• Administrative Wage Garnishment<br>• Lawsuit and Judgment Collection | Private Student lenders can collect through:<br>• Lawsuit and Judgment Collection |

# Differences Between Federal & Private Student Loans

| Bankruptcy Discharge | |
|---|---|
| Federal | Private |
| Both federal and private student loans are subject to discharge if repayment would constitute an "undue hardship", generally under the *Bruner* test. (Which is beyond the scope of this talk.) | |

# Differences Between Federal & Private Student Loans

| Cancellation | |
|---|---|
| Death | |
| Federal | Private |
| The obligation to repay federal loans ends with the borrower's death or, for Parent Plus loans, the death of the student. | Private loans are also discharged by the death of the borrower, but not necessarily for the co-borrower. |
| Federal loans cannot collect from the decedent's estate. | Private student loans can collect from the decedent's estate. |

# Differences Between Federal & Private Student Loans

| Cancellation | |
|---|---|
| Disability | |
| Federal | Private |
| A determination by the Social Security or Veteran's Administrations that the borrower is "totally and permanently disabled" can result in an administrative discharge, if the condition persist for at least 3 years. | Private loans have no requirement of forgiveness due to disability. |

# Differences Between Federal & Private Student Loans

| Forgiveness | |
|---|---|
| Public Service Loan Forgiveness | |
| Federal | Private |
| An borrower employed by the government or a 501(c)(3) can have Direct Loans forgiven after making 120 payments, including under an IDR. | None. |

# Defaulted Federal Loans

| Default |
| --- |
| Definition |
| No Payments for more than 270 days. |
| Consequences |
| • The entire unpaid balance is due and payable.<br>• Loss of eligibility for *deferment*, *forbearance*, and repayment plans.<br>• Loss of eligibility for additional *federal student aid*.<br>• Loan is assigned to a collection agency.<br>• The loan will be reported in default to credit bureaus<br>• Intercept of tax refunds.<br>• Balance will increase because of the late fees, additional interest, court costs, collection fees, attorney's fees, and any other costs associated with the collection process.<br>• Administrative wage garnishment.<br>• Commencement of legal action.<br>• Possible Suspension of Professional or Driver's Licenses. |

# Solutions for Defaulted of Federal Loans

| Settlement |
| --- |
| Direct Loans |
| • Waiver of Collection Costs: Payment of the current principal and interest (waiver of collection costs/fees). |
| Example: Borrower owes $2500.00 Principal, $ 1000.00 Interest, and $875.00 projected collection fees. The collector may offer the borrower a settlement as low as $3500.00 (Principal and Interest) to fully satisfy the account. |
| • Principal and Half Interest: Payment of at least the current principal and 50% of interest. |
| Example: Borrower owes $2000.00 Principal, $1000.00 Interest and $730.20 projected collection costs. The collector may offer the borrower a settlement as low as $2,500.00 (principal + 50% interest) to fully satisfy the account. |
| • 90% principal and interest: Payment of at least 90% of the current principal and interest balance. |
| Example: Borrower owes $2000.00 Principal, $400.00 Interest and $584.16 projected collection costs. The collector may offer the borrower a settlement as low as $2160.00 (90% of principal + interest) to fully satisfy the account. |

# Solutions for Defaulted of Federal Loans

| Consolidation |
| --- |
| Consolidation is essentially a refinancing of all existing student loans into one Direct Loan. |
| In something of an oxymoron, a single loan can be consolidated. |
| The borrower must agree to repay the consolidated loan under an Income Driven Repayment Plan. |
| The Interest Rate for the new consolidated loan will be a weighted average of the previous loans. |
| Consolidation may include collection costs of up to 18.5% of the principal and interest outstanding on the defaulted loan. |
| Default on Student Loans can only be cured once through consolidation, unless other loans are later consolidated. |
| Consolidation generally takes 30-90 days. |

# Solutions for Defaulted of Federal Loans

| Rehabilitation |
|---|
| Rehabilitation requires the borrower to make nine (9) payments in ten (10) months. |
| Payments must be reasonable and affordable, based on review and IDR. |
| Payments made through Administrative Wage Garnishment do not count. |
| Nor does the Administrative Wage Garnishment stop until five (5) payments have been made. |
| Rehabilitation may include collection costs of up to 18.5% of the principal and interest outstanding on the defaulted loan. |
| Default on Student Loans can only be cured once through rehabilitation, unless other loans are later also rehabilitated. |

# Solutions for Defaulted of Federal Loans

| Chapter 13 |
|---|
| 11 U.S.C. § 1322(b)(3) provides that "the plan may … provide for the curing or **waiving** of **any default**." (Emphasis added.) |
| "Any default" should include student loan or even a default under a rehabilitation. |
| "Curing", which generally means catching up on missed payments, must mean something different from "waiving", which implies forgiving of missed payments. |
| 11 U.S.C. § 1322(b)(5), which routinely is used to allow the cure and maintenance of mortgage payments, specifically allows the same treatment for "any unsecured claim … on which the last payment is due after the date on which the final payment under the plan is due", which would include non-dischargeable student loans. |
| Such a cure or waiver could avoid the assessment of collection costs of up to 18.5% of the outstanding principal and interest. |
| It should be expected that such a plan would face vigorous opposition from the Department of Education and heightened judicial scrutiny. |

# Differences Between Federal & Private Student Loans

| Repayment Options | |
| --- | --- |
| **Federal** | **Private** |
| The federal government has panoply of repayment options, including standard, extended and assorted income drive plans. | Private Student lenders have not mandatory repayment options other than the contract or a negotiated settlement. |

# Federal Loan Repayment Options

- Standard Repayment
  - Term of up to 10 years
- Graduated Repayment
  - Term of 10 years
  - Amount steps up every two years.
- Extended Repayment
  - Balance of over $30k
  - Term of up to 25 years
- Extended Graduated Repayment
  - Balance of over $30k
  - Term of up to 25 years
  - Amount steps up every two years.

# Federal Loan Repayment Sample

| Original Loan Amount (3.4% Interest Rate) | $25,000 | $50,000 | $100,000 |
|---|---|---|---|
| Standard | $246 | $492 | $984 |
| Graduated | $159 | $318 | $636 |
| Extended | N/A | $248 | $743 |
| Extended Graduated | N/A | $142 | $283 |

# Federal Loan Repayment Options
# Income Driven Repayment Plans

- Income Contingent Repayment (ICR)
- Income Based Repayment (IBR)
- Pay As You Earn (PAYE)

# Federal Loan IBR Repayment Sample

| | Total Household Income | | |
|---|---|---|---|
| Household Size | $25,000 | $50,000 | $100,000 |
| 1 | $50 | $420 | $1,050 |
| 2 | $0 | $350 | $970 |
| 3 | $0 | $280 | $900 |
| 4 | $0 | $210 | $830 |

# Federal Loan Repayment Calculation

- To calculate the various student loan repayment options, go to:

https://studentloans.gov/myDirectLoan/mobile/repayment/repaymentEstimator.action

# Participation in IDR and Chapter 13

- Previously the Department of Education, its Guaranty Agencies and Student Loan Servicers would place all student loans for Chapter 13 Debtors in administrative forbearance.
- This meant that no collection actions were taken, but interest continued to accrue.
- Accordingly, $100,000 of student loans at 8% interest will grow to $148,984.57 at the end of a 60-month Chapter 13 Plan.
- The “fresh start” becomes a “false start.”

# Participation in IDR and Chapter 13

- The Department of Education had refused to allow Chapter 13 Debtors to participate in the various income driven repayment plans.
- When pressed with the argument that 11 U.S.C. § 525(c) prohibited such discrimination, the Department of Education consented to allowing Chapter 13 Debtors to participate in IDRs if Chapter 13 Plans contained the following provisions from the *Buchanan* case:

# *Buchanan* Provisions

- The Debtor is not seeking nor does this Plan provide for any discharge, in whole or in part, of her student loan obligations.

An over-arching concern by the Department of Education appears to be that, following *United Student Aid Funds, Inc. v. Espinosa*, 559 U.S. 260 (2010), "unscrupulous debtors [will] abuse the Chapter 13 process by filing plans proposing to dispense with the undue hardship requirement in the hopes the bankruptcy court will overlook the proposal and the creditor will not object." *Id.* at 16.

It is best to address this concern directly, both by specifically disavowing any present attempt at discharge and by asking that the Plan be specially set for a Confirmation Hearing.

# *Buchanan* Provisions

- The Debtor shall be allowed to seek enrollment in any applicable income-driven repayment (“IDR”) plan with the U. S. Department of Education and/or other student loan servicers, guarantors, etc. (Collectively referred to hereafter as “Ed”), without disqualification due to her bankruptcy.

This is a fundamental change in practice by Ed. and its servicers, which previously refused to consider applications by Chapter 13 debtors for IDRs, instead placing student loans into an “administrative forbearance.”

The basis for this provision is the prohibition in 11 U.S.C. § 525 (c) which provides that a “A governmental unit that operates a student grant or loan program ... may not deny a student grant, loan, loan guarantee, or loan insurance to a person that is or has been a debtor under this title ... because the debtor ... is ... a debtor under this title....”

# *Buchanan* Provisions

- Ed shall not be required to allow enrollment in any IDR unless the Debtor otherwise qualifies for such plan.

This is meant to prevent the debtor from asserting the confirmation of the plan on its own enrolled the Debtor  in an IDR or that the Debtor was given any special preference.

# *Buchanan* Provisions

- The Debtor may, if necessary and desired, seek a consolidation of her student loans by separate motion and subject to subsequent court order.

Consolidation of several student loans may be necessary for enrollment in a specific IDR or if the debtor was in default on her student loans. The plan provides that this will be approved by separate motion.

# *Buchanan* Provisions

- Upon determination by Ed of her qualification for enrollment in an IDR and calculation of any payment required under such by the Debtor, the Debtor shall, within 30 days, notify the Chapter 13 Trustee of the amount of such payment. At such time, the Trustee or the Debtor may, if necessary, file a Motion to Modify the Chapter 13 Plan to allow such direct payment of the student loan(s) and adjust the payment to other general unsecured claims as necessary to avoid any unfair discrimination.

This provides that once the monthly payment under an IDR is determined, the debtor will notify the Chapter 13 Trustee, who would then have an opportunity to decide whether that requires a higher dividend to unsecured creditors and if the IDR should be made directly or by "conduit."

# *Buchanan* Provisions

- The Debtor shall re-enroll in the applicable IDR annually or as otherwise required and shall, within 30 days following a determination of her updated payment, notify the Chapter 13 Trustee of such payment. At such time, the Trustee or the Debtor may, if necessary, file a Motion to Modify the Chapter 13 plan to allow such direct payment of the student loan(s) and adjust the payment to other general unsecured claims as necessary to avoid any unfair discrimination.

This provides a bit of a "carrot" for the Chapter 13 Trustee in consenting to the plan, in that the debtor will annually notify the Trustee of changes in the monthly IDR, which could result in a higher dividend to other unsecured creditors.

# *Buchanan* Provisions

- During the pendency of any application by the Debtor to consolidate her student loans, to enroll in an IDR, direct payment of her student loans under an IDR, or during the pendency of any default in payments of the student loans under an IDR, it shall not be a violation of the stay or other State or Federal Laws for Ed to send the Debtor normal monthly statements regarding payments due and any other communications including, without limitation, notices of late payments or delinquency. These communications may expressly include telephone calls and e-mails.

The second greatest concern by Ed. appears to be that this plan is a devious attempt to trick student loan servicers into violating the automatic stay. The communications allowed are patterned on those with mortgage servicers, but stop short of allowing non-bankruptcy garnishment or other involuntary collection.

# *Buchanan* Provisions

- In the event of any direct payments that are more than 30 days delinquent, the Debtor shall notify her attorney, who will in turn notify the Chapter 13 Trustee, and such parties will take appropriate action to rectify the delinquency.

This is to allow for monitoring of the IDR payments if made directly by the debtor.

It is important to remember that in regards to student loans, "delinquent" may not be the same as "default", which requires that no payments have been made for more than 270 days. *See* 34 C.F.R. § 685.102.

# *Buchanan* Provisions

- The Debtor’s attorney may seek additional compensation by separate applications and court order for services provided in connection with the enrollment and performance under an IDR.

This clearly the most important provision in this plan, allowing separate and additional compensation for these services.

# Options for Chapter 13 Allowance of IDR

- Separate Classification
- Co-Sign Protection
- Above-median debtor pays student loan from discretionary  income, i.e. Social Security or belt-tightening, earned in excess of PDI
- Below-median debtor extends plan to five years
- Pro Rated Distribution to Other General Unsecured Claims
- Chapter 20

# Documents

This Presentation and document are available at:

www.ncbankruptcyexpert.com

- Click on Student Loan Options and Chapter 13 Bankruptcy
- Password: IDR13

- Thanks to Prof.  Susan Hauser for statistics,  John Rao for case law and Joshua Cohen for details regarding student loan programs.