

ANALYSIS OF THE BANKRUPTCY PROVISION FOR STUDENT LOAN DEBT

by
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A capstone project submitted to Johns Hopkins University in conformity with the
requirements for the degree of Master of Arts in Public Management

Baltimore, Maryland
May 2014

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MEMORANDUM

TO: Senator Tom Harkin, Chair, Senate Health Education Labor and Pensions

Committee

FROM: Brandy Blevins, Concerned Student Loan Borrower

SUBJECT: Analysis of the Bankruptcy Provision for Student Loan Debt

DATE: 21 April 2014

I. Action-Forcing Event:

The Higher Education Act (HEA) is due for reauthorization this year. The HEA is the legislation that governs how federal money is distributed to colleges and students and must be reauthorized every four to six years. Congress has solicited recommendations from industry and the public at-large on how to improve the current act. This memo discusses some of the key concerns with the growing student loan debt and proposes a policy solution for possible inclusion into the 2014 HEA.

II. Statement of Problem:

At \$1.2 trillion and growing 14 percent annually, student loan debt has surpassed all other forms of household debt, with the exception of home mortgages.¹ Research shows that borrowers from middle class families are bearing the brunt of this burden and the growing inability of borrowers to repay their student loans could be problematic for the recovering economy.

¹ Denhart, Chris. "How the \$1.2 Trillion College Debt Crisis is Crippling Students, Parents and The Economy." *Forbes*, August 8, 2013, <http://www.forbes.com/sites/specialfeatures/2013/08/07/how-the-college-debt-is-crippling-students-parents-and-the-economy/>;
Morris, Patrick. "President Obama is Right. The Student Loan Crisis is Scary and Getting Worse." *Daily Finance*, February 2, 2014, <http://www.dailyfinance.com/2014/02/02/president-obama-is-right-the-student-loan-crisis-i/>.

A combination of factors has led more families to rely on student loans to finance college tuition. Some key factors attributing to the surge in student loan borrowing include higher education expenses and a reduction in state funding for public universities. According to the Institute for College Access and Success, “state budget cuts led to sharp tuition increases at many public colleges, increasing students’ need to borrow.”² In fact, college tuition and associated fees have increased by nearly 80 percent from August 2003 to August 2013.³

A disturbing one in seven borrowers defaulted on their federal student loan payments in 2012 and 40 percent of federal loans are in deferment, forbearance or default.⁴ This figure does not include private loans, which account for about one-fifth of the market.⁵ These findings seem to indicate that borrowers are struggling with repaying their loans. A default on student loan payments can have long-term consequences such as tarnished credit scores, negatively impacting one’s ability to borrow money later down the road.

Acquiring a college education has become a prerequisite for entry into the middle class with nearly two-thirds of the middle class possessing a college degree.⁶ Rising student loan debt levels are a major contributor to the middle class debt profile. Because the median income for the middle class has continued to decrease over the last 12 years,

² Kingkade, Tyler. “Average Student Debt Climbs to \$29,400, Up 63 Percent in Less than a Decade: A Study.” *The Huffington Post*, December 4, 2013, http://www.huffingtonpost.com/2013/12/04/average-student-debt-2012_n_4380946.html.

³ Kurtzleben, Danielle. “Charts: Just How Fast Has College Tuition Grown.” *US News Online*, October 23, 2013, <http://www.usnews.com/news/articles/2013/10/23/charts-just-how-fast-has-college-tuition-grown>.

⁴ Kirkham, Chris and Shahien Nasirpour. “Student Loan Defaults Surge to Highest Level in Nearly Two Decades.” *The Huffington Post*, September 30, 2013, http://www.huffingtonpost.com/2013/09/30/student-loans-default_n_4019806.html.

⁵ The Institute for College Access & Success. “Student Debt and the Class of 2012.” Project on Student Debt. December 2013, <http://projectonstudentdebt.org/files/pub/classof2012.pdf> (accessed 02/22/14).

⁶ Naidu-Ghelani, Rajeshni. “What does it mean to be ‘Middle Class’?” *The Huffington Post*, July 31, 2013, http://www.huffingtonpost.com/2013/07/31/middle-class-study_n_3683711.html.

the increasing student loan debt levels are becoming a heavier burden and likely contributing to a decrease in disposable income, affecting ability to purchase goods and services.⁷ When the “world’s largest consumer group” cannot purchase and invest at will, the economy inevitably suffers.

III. History:

Throughout history the importance of higher education has been emphasized time and again. Some suggest that the Soviet Union’s launch of Sputnik was the single event that prompted the United States to reevaluate its current education system and rethink the availability of higher education for its citizens.

G.I. Bill

The Servicemen’s Readjustment Act of 1944, otherwise known as the G.I. Bill, was signed into law by Franklin D. Roosevelt as part of his New Deal reforms.⁸ The hope was that this new legislation would help the nation avoid another depression and encourage returning veterans to seek higher education. This bill was the inception of government funded education and transformed the higher education system in America by diversifying the face of college students and expanding opportunity for thousands. The G.I. Bill meant that a college education was no longer a privilege for the wealthy and introduced the idea of government funded higher education. By 1947 over half of the enrolled college students were veterans taking advantage of the new GI Bill.⁹

National Defense Education Act

⁷ Miller, Keith and David Madland. “Three Charts Showing How Middle-Class Incomes Continue to Stagnate While Overall Inequality Grows.” Center for American Progress Action Fund, September 17, 2013, <http://www.americanprogressaction.org/issues/labor/news/2013/09/17/74366/3-charts-showing-how-middle-class-incomes-continue-to-stagnate-while-overall-inequality-grows/> (accessed 03/01/14).

⁸ United States Department of Veterans Affairs. “GI Bill: History and Timeline.” <http://www.benefits.va.gov/gibill/history.asp> (accessed 02/22/14).

⁹ This Day in History. “FDR Signs GI Bill, 1944.” The History Channel. <http://www.history.com/this-day-in-history/fdr-signs-gi-bill> (accessed 02/22/14).

The Cold War and the Soviet Union's launch of Sputnik led President Dwight Eisenhower to make an urgent push for strengthening the nation's public school system and secondary education to meet America's growing national security demands. President Eisenhower passed the National Defense Education Act (NDEA) in 1958 which urged Americans to regain the competitive edge in the areas of science, technology, and math and further encouraged citizens to pursue higher education.¹⁰ Provisions in this act included loan assistance, fellowships, and grants for students who studied in areas of math, science, engineering, and foreign language.

This act opened up postsecondary education for non-veterans and provided more Americans with the opportunity to enroll in college through the newly established National Defense Student Loan (NDSL) program, which was the predecessor to today's Federal Perkins Loan Program. The act was criticized for its limited curriculum focus on science and technology and the increased government presence in the educational system. In 1964, the NDEA was amended by expanding the list of subjects or areas of study for which assistance could be given. The NDEA marked the beginning of large-scale involvement of the U.S. federal government in the education system.

Economic Opportunity Act of 1964

President Lyndon Johnson signed the Economic Opportunity Act in 1964 as part of his War on Poverty. This act was designed to expand opportunities for individual

¹⁰ *Encyclopedia Britannica Online*. s.v. "National Defense Education Action (NDEA)." <http://www.britannica.com/EBchecked/topic/404717/National-Defense-Education-Act-NDEA> (accessed 02/22/14).

initiative and set forth various programs to help poor and low-income students assimilate into to society by providing skills and education through work-study programs.¹¹

Higher Education Act of 1965

In President Johnson's 1965 State of the Union Address, he laid out his goal of improving the quality of American life through education and recommended a new program for schools and students that provided scholarships and low-interest loans to college students.¹² This program became known as the Higher Education Act (HEA) and was enacted in November 1965 as part of President Johnson's "Great Society" agenda.

This HEA "established a much wider set of higher education subsidies...to fund this new democratization of college. These included grants, loans, and work-study, which grew into what we now know as Pell Grants, Stafford Loan, and Federal Work-Study programs, respectively."¹³ Perhaps the most significant contribution of the 1965 HEA was the establishment of the Title IV programs, which include today's Stafford Loan. This act changed the way the program was financed by expanding disbursement of government-backed student loans to banks and non-profit lenders.¹⁴ Previously, the United States Treasury was the responsible entity for financing student loans.

The Higher Education Act - Amendments

Since its inception in 1965, the HEA has been amended nine times and expired at the end of 2013. Notable amendments to the HEA include the 1998 revisions to

¹¹ Davies, Gareth. "War on Dependency: Liberal Individualism and the Economic Opportunity Act of 1964." *Journal of American Studies*, Vol. 26, No. 2 (Aug., 1992), pp. 205-231. <http://www.jstor.org/stable/27555646> (accessed 02/22/14).

¹² President Lyndon B. Johnson: "Annual Message to the Congress on the State of the Union," January 4, 1965. Online by Gerhard Peters and John T. Woolley, *The American Presidency Project*. <http://www.presidency.ucsb.edu/ws/?pid=26907> (accessed 02/22/14).

¹³ Freedman, Josh. "Risky Business: Why Student Loans are the Worst Way to Fund College." *Forbes*, February 10, 2014 (accessed 02/10/14).

¹⁴ Cass, Connie. "History of Student Loans: Why Uncle Sam is Your Banker." *The Huffington Post*, July 19, 2013, http://www.huffingtonpost.com/2013/07/19/history-of-student-loans_n_3622709.html (accessed 02/24/14).

eliminate the borrower's right to refinance following loan consolidation, the power of the U.S. government to garnish wages to secure repayment of loans, and the ability to take away state-issued professional licenses and termination of public employment.¹⁵ These 1998 additions expanded the enforcement power of the federal government and holds borrowers to a higher level of accountability. Because of this amendment, defaulting on a student loan now carries even greater consequences.

Other Notable Student Loan Legislation

Over time there have been other legislative changes to the student loan system through the 1978 Middle Income Student Assistance Act (MISSA), Omnibus Reconciliation Act of 1993, Higher Education Reconciliation Act of 2005, the Ensuring Continuing Access to Student Loans Act of 2008, and the Health Care and Education Reconciliation Act of 2010, to name a few. These bills were all enacted outside of HEA reauthorizations and all had significant impacts on the student aid program.

In the case of the Health Care and Education Reconciliation Act, the health-related aspects of this legislation obscured the education aspects, but this bill included notable changes to the student loan program. This act most notably eliminated the Federally-guaranteed student loan program (FFELP) and now all loans since 2010 have been direct loans.¹⁶ In addition, the Reconciliation Act altered how student loans are repaid by modifying the Income Based Repayment Plan to cap monthly payments from 15 percent down to 10 percent and granting loan forgiveness at twenty years instead of twenty-five years.

¹⁵ Wenisch, Michael. "The Student Loan Crisis and the Future of Higher Education." *Catholic Social Science Review* 17, (October 2012): 345-350. *OmniFile Full Text Mega (H.W. Wilson)*, EBSCOhost (accessed 03/03/14).

¹⁶ Samuelson, Tracey. "Student Loan Reform: What will it mean for Students?" *Christian Science Monitor*, March 3, 2010, <http://www.csmonitor.com/Business/2010/0330/Student-loan-reform-What-will-it-mean-for-students> (accessed 02/25/14).

Student Loans and Bankruptcy

Prior to 1976, student loans were eligible for discharge through bankruptcy, with no exceptions. Congress amended the U.S. Bankruptcy Code (11 U.S.C. § 523 (a)(8)) in 1976 through the HEA in response to potential concerns that borrowers could abuse the system by filing for bankruptcy to absolve their student loans. This revision required that federal loans be in repayment for five years (this later became seven years) or by proving “undue hardship” before becoming eligible for dismissal under bankruptcy law.¹⁷

Over time Congress continued to withdraw bankruptcy protection for student loans. In 1998, Congress further amended the Bankruptcy Code so that no federal student loan could be discharged without proof of the undue hardship burden, regardless of how long the loan been in repayment.¹⁸ Individuals seeking dismissal of student loans have to file for an additional bankruptcy proceeding where the debtor has the onus of demonstrating that paying the student loans would constitute an undue hardship. Judges may vary on their interpretation of undue hardship as this term was not defined by Congress.

As Congress continued to tighten the language surrounding student loans and bankruptcy, it became clear that the intent was for student loans to be discharged only in rare circumstances.

Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA)

In 2005, Congress even further constricted Bankruptcy Code and passed the BAPCPA, which expanded the law so that no federally funded or private student loan could be discharged in bankruptcy. Prior to this, private loans were treated as any other

¹⁷ Paperno, Barry. “Do We Need to Change Bankruptcy Rules for Student Loans?” *Yahoo Finance*, March 8, 2013, <http://finance.yahoo.com/news/change-bankruptcy-rules-student-loans-050119756.html>.

¹⁸ Grant, Kyle. “Student Loans in Bankruptcy and the ‘Undue Hardship Exception’ Who Should Foot the Bill?” *Brigham Young University Law Review* (September 2011): 819-847.

private debt and fully dischargeable under bankruptcy. This new legislation appeared to have been passed with little debate or public awareness.

Since the Act's inception, several unsuccessful attempts have been made by Members of Congress to reverse or amend the legislation. Currently, student loans are not eligible to be absolved in a debtor's traditional bankruptcy proceeding. Instead, debtors are required to file for an adversary proceeding where a second hearing occurs and the judge makes a determination if the filer meets the undue hardship burden.

IV. Background:

Over \$1.2 trillion dollars in student loan debt looms and threatens economic growth by hampering one of the nation's most essential economic drivers: the middle class. While many initiatives and programs exist to help those about to incur educational debt, little has been done to address those already suffering from an unmanageable load of student loan debt.

Student loan debt has risen over 300% in the last 10 years and delinquencies on student loan repayments continue to climb.¹⁹ In fact, the Department of Education spent \$1.4 billion in 2011 to pay collection agencies to "track down students whose loans are delinquent or in default."²⁰ Student loan debt has surpassed all other forms of debt with the exception of home mortgages.²¹ The group most affected by this mounting debt is the middle class because low-income families can take advantage of grants and other types of financial aid while wealthy families typically don't have to worry about how to finance education costs. Some suggest student loan debt is largely responsible for contributing to

¹⁹ Frizell, Sam. "Student Loans are Ruining Your Life. Now they're ruining the Economy, Too." *TIME*, February 26, 2014, <http://business.time.com/2014/02/26/student-loans-are-ruining-your-life-now-theyre-ruining-the-economy-too/?iid=biz-main-lead>.

²⁰ Elliott, William and Il Sung Nam. "Is Student Debt Jeopardizing the Short-Term Financial Health of U.S. Households?" Federal Reserve Bank of St. Louis, (September/October 2013): 406.

²¹ Elboghdady, Dina. "Student Debt is Terrible, in Charts." *The Washington Post*, February 21, 2014, <http://www.washingtonpost.com/blogs/wonkblog/wp/2014/02/18/student-debt-is-terrible-in-charts/>.

the widening of the U.S. wealth gap.²² Those borrowers who have to take out student loans don't start on the same level as those who graduate and can begin building equity immediately.

This rising debt is problematic because the middle class is the largest consumer group and a significant driver of the economy. The Center for American Progress asserts that the middle class is the “heartbeat of the economy” by serving as the primary economic driver, representing the largest portion of the workforce, spurring investment and entrepreneurship, and is ultimately the key to national stability.²³ President Obama has reiterated the importance of a strong middle class and in his recent speech on economic mobility he commented that the middle class has been the “engine of our prosperity.”²⁴

Student loan debt may be causing young people to delay purchasing cars, homes, and starting families. According to the Center for American Progress, “two million more adults between the ages 18-34 live with their parents than before the recession.”²⁵ This slowed life progression could cause the economy to lag as young people are working to cope with their accrued college debts. A recent analysis conducted by the Mortgage Bankers Association “found that loan applications for home purchases have slipped nearly 20 percent in the past four months compared with the same period a year

²² Thompson, Carolyn. “\$1 Trillion Student Loan Debt Widens Wealth Gap.” *The Associated Press*, March 27, 2014, <http://bigstory.ap.org/article/1-trillion-student-loan-debt-widens-us-wealth-gap>.

²³ Ettlinger, Michael. Middle Class Series: A Strong Middle Class is Key to Getting Our Economy Moving.” Center for American Progress, December 6, 2011, <http://www.americanprogress.org/issues/economy/news/2011/12/06/10791/a-strong-middle-class-is-key-to-getting-our-economy-moving/>.

²⁴ The White House, Office of the Press Secretary. “Remarks by the President on Economic Mobility.” December 4, 2013, <http://www.whitehouse.gov/the-press-office/2013/12/04/remarks-president-economic-mobility>

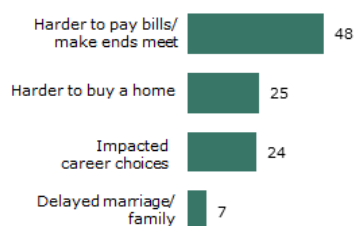
²⁵ Bergeron, David, Elizabeth Baylor, and Joe Valenti. “Resetting the Trillion-Dollar Student Loan Debt Problem.” Center for American Progress, November 21, 2013, <http://www.americanprogress.org/issues/higher-education/report/2013/11/21/79821/resetting-the-trillion-dollar-student-loan-debt-problem/>.

earlier.”²⁶ This is concerning because first-time home owners account for a significant portion of the housing market and some housing experts claim that student loan debt may be partially to blame for this lag in home sales. The Chief Executive of the Mortgage Bankers Association recently stated “Student debt trumps all other consumer debt. It’s going to have an extraordinary dampening effect on young peoples’ ability to borrow for a home, and that’s going to impact the housing market and the economy at large.”²⁷ In 2011, Pew Research Center conducted a poll to determine in what areas respondents felt that student loans were having the greatest financial burden. This poll found that about half of the respondents reported that student loans have made it more difficult to make ends meet. The chart below highlights those financial areas in which respondents felt they were most negatively affected.

Figure-1

How Student Debt Affects Borrowers

% of student borrowers who say having to pay back student loans had this impact on them



Note: Based on those who took out loans for postsecondary education and are not currently enrolled in school, n=332.

PEW RESEARCH CENTER GP/29

Source: Pew Research Center²⁸

²⁶ El Boghdady, Dina. Student Debt May Hurt Housing Recovery by Hampering First-Time Buyers. *The Washington Post*, February 14, 2014, http://www.washingtonpost.com/business/economy/student-debt-may-hurthouse-recovery-by-hampering-first-time-buyers/2014/02/17/d90c7c1e-94bf-11e3-83b9-1f024193bb84_story.html (accessed 03/17/14).

²⁷ Ibid.

²⁸ The Pew Research Center. “College Graduation: Weighing the Cost...and the Payoff.” May 17, 2012, <http://www.pewresearch.org/2012/05/17/college-graduation-weighing-the-cost-and-the-payoff/>.

There are likely many contributing causes as to why these middle class families and individuals cannot afford to make their student loan payments and circumstances vary between cases. However, there are several key factors that may help to explain the reasons for student loan delinquency rates and the middle class' inability to repay these loans. Likely factors contributing to this phenomenon include the disparity between student debt and median income levels and the absence of relief for burdened borrowers.

Key Issues

Student Debt Levels Rising While Median Income Remains the Same

The United States' median income level has dropped nine percent since 1999.²⁹

However, the cost of living and college tuition have continued to rise steadily over this same time period making it increasingly difficult for borrowers to repay student loans.

While college-educated Americans may be better off than their high school educated counterparts, they are still finding it difficult to find gainful employment.

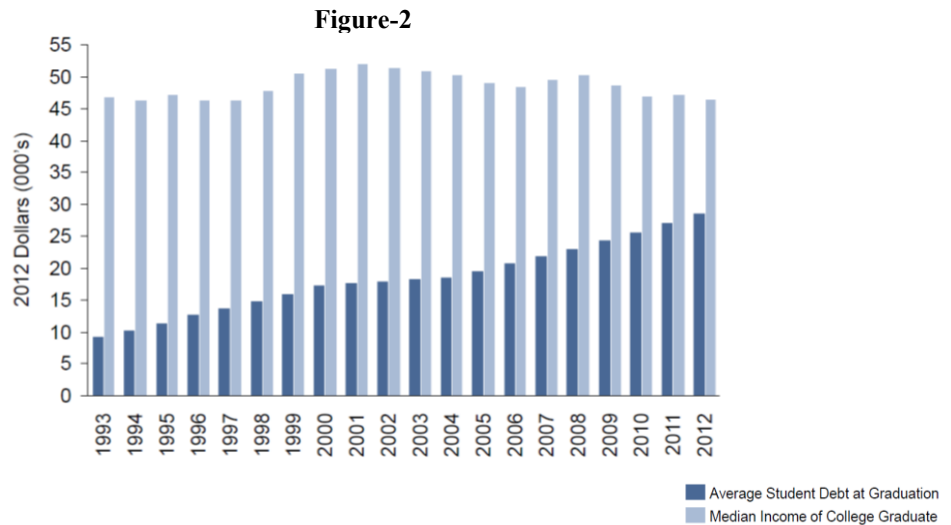
In a stagnant job market and lagging economy, college graduates may be forced to accept employment that is not requisite to the education they have achieved. Even with the overall unemployment rate decreasing, college graduates are still having difficulty securing employment commensurate with their education level. According to the Bureau of Labor Statistics, "the number of college graduates working minimum wage jobs is nearly 71 percent higher than it was a decade ago."³⁰ To put it simply, student loan borrowers are not seeing the same historical return on their investment.

To better illustrate this, Figure-2 shows how the increase in student loan debt over time has reduced the return on college investment. The y-axis represents the median

²⁹ Hamilton Place Strategies. "The Economics of College Cost: Background for President Obama's College Tour, August 22-23, 2013."

³⁰ Kurtzleben, Danielle. "Twice as Many College Grads in Minimum Wage Jobs as 5 Years Ago." *U.S. News*, December 5, 2013, <http://www.usnews.com/news/articles/2013/12/05/twice-as-many-college-grads-in-minimum-wage-jobs-as-5-years-ago>.

income of college graduates in the thousands while the x-axis represents the graduation year.



Source: FinAid 2012, Current Population Survey³¹

If debt and median income levels continue along this trajectory, student debt levels at the time of graduation will equal the median income by 2023.³² This demonstrates that a problem exists and we cannot sustain this accelerating trend.

Little Reprieve for Those Who Already Face Student Loan Repayment

For borrowers whose grace periods have ended and have started to feel the weight of student loan repayment, there are very few options offered to help with debt relief. Most notably student loans are not dischargeable through bankruptcy and oftentimes student loans are not eligible for refinancing.

The traditional benefits of U.S. bankruptcy do not apply to educational loans. In addition to filing for bankruptcy, Congress requires the debtor to file an adversary proceeding where he or she must demonstrate proof that repayment of the education

³¹ Hamilton Place Strategies. "The Economics of College Cost: Background for President Obama's College Tour, August 22-23, 2013."

http://www.hamiltonplacestrategies.com/sites/default/files/newsfiles/HPS%20The%20Economics%20Of%20College%20Costs_1.pdf.

³² Ibid.

loans would constitute an “undue hardship.”³³ However, Congress has not defined “undue hardship” and instead has left this determination up to the judicial system, resulting in a somewhat nebulous interpretation of what constitutes such hardship. A study conducted in 2007 showed that out of the “170,000 student loan debtors who filed for bankruptcy, only 51 won full discharges of their debt while 30 received partial discharges.”³⁴ While not entirely impossible to achieve, discharging student loans through bankruptcy is extremely difficult and proving undue hardship is an ambiguous and high threshold to clear.

A report issued by the National Association of Consumer Bankruptcy Attorneys (NACBA) found that potential clients they encounter with student loan debt have “significantly” or “somewhat increased” over the last three to four years.³⁵ While no metrics currently exist that could determine a causal relationship between individual student loan debt and bankruptcy filings, this study may indicate that student loan debt could be a contributing factor for those who are considering bankruptcy.

While there appears to have been some steps taken to permit refinancing in the private loan market, the federal government has not been receptive to such refinancing for government issued student loans. After the Great Recession, many home owners were able to take advantage of the lowered mortgage interest rates, but student loans were off the table. A report from the Center for American Progress showed that most student

³³ Iuliano, Jason. "An Empirical Assessment of Student Loan Discharges and the Undue Hardship Standard." *American Bankruptcy Law Journal* 86, no. 3 (Summer 2012): 495-525. *Business Source Complete*, EBSCOhost (accessed 03/14/14).

³⁴ Weston, Liz. “Bankrupt? How to Get Student Loan Debt Erased.” *Reuters*, March 3, 2013, <http://www.reuters.com/article/2014/03/03/column-weston-bankruptcy-column-idUSL1N0LX1FW20140303>.

³⁵ Webley, Kayla. “Why Can’t You Discharge Student Loans in Bankruptcy?” *TIME*, February 9, 2012, <http://business.time.com/2012/02/09/why-cant-you-discharge-student-loans-in-bankruptcy/>.

loan debt has interest rates higher than six percent.³⁶ The Center went on to explain that if borrowers were permitted to refinance at five percent, borrowers would have saved \$14 billion in 2013.³⁷

Key Players

There are many interested parties weighing in on the student loan reform debate and we will likely see more as Congress begins its deliberations on the HEA reauthorization. The facilitators of this discussion are the White House and Congress and they will ultimately be the decision-makers on this issue. The Department of Education and Consumer Financial Protection Bureau have a large stake in any decisions made on Capitol Hill as they will be the ones tasked with overseeing any reforms and ensuring those reforms are adhered to.

The Obama Administration

President Obama's 2014 State of the Union address underscored the importance of education and the right of every child in America to have access to a world-class education. He acknowledged the need for Congress to confront the growing student loan debt and urged members to help Americans "who feel trapped by student loan debt."³⁸ In addition, during his college tour last August, President Obama remarked "our economy can't afford the trillion dollars in outstanding student-loan debt, much of which may not get repaid because students don't have the capacity to pay it."³⁹

³⁶ Kadlec, Dan. "Why Can't People with Student Loans Refinance at Better Rates?" *TIME - Educational Financing*, February 20, 2013, <http://business.time.com/2013/02/20/why-cant-people-with-student-loans-refinance-at-better-rates/>.

³⁷ Ibid.

³⁸ President Obama. "FULL TRANSCRIPT: Obama's 2014 State of the Union Address." *The Washington Post*, January 28, 2014, http://www.washingtonpost.com/politics/full-text-of-obamas-2014-state-of-the-union-address/2014/01/28/e0c93358-887f-11e3-a5bd-844629433ba3_story.html (accessed 02/09/14).

³⁹ The White House, Office of the Press Secretary. "Remarks by the President on College Affordability – Buffalo, NY." (08/22/13). <http://www.whitehouse.gov/the-press-office/2013/08/22/remarks-president-college-affordability-buffalo-ny>.

Education ranks high on the Administration's domestic agenda and with the HEA set to expire this year, this issue has received even more exposure. In a recent press release, the White House underscored President Obama's commitment to education and outlined his achievements to include "historic investments in college affordability, increasing the maximum Pell Grant award for working and middle class families by more than \$900, creating the American Opportunity Tax Credit, and enacting effective student loan reforms eliminating bank subsidies and making college more affordable."⁴⁰ The White House blog called higher education "the clearest pathway to the middle class." There is little question about the value the Administration places on education and where it stands on the issue.

The president's goal is for America to have the highest proportion of college graduates by 2020. In hopes of achieving this goal, the president has proposed several new initiatives to help jump-start the discussions surrounding the student loan program starting in 2010 with the "improved" income-based repayment Plan (IBR) which allows former students to cap federal loan payments at 10 percent of their discretionary income (previously 15 percent). To take advantage of this program, borrowers determine eligibility and sign up through the Department of Education's website.⁴¹

The Administration has called for greater transparency of the student loan process and for new ways to help keep college affordable. The White House recommends several measures to achieve these goals. Most notably, President Obama has proposed the

⁴⁰ The White House, Office of the Press Secretary. "Fact Sheet on the President's Plan to Make College More Affordable: A Better Bargain for the Middle Class." (08/22/13). <http://www.whitehouse.gov/the-press-office/2013/08/22/fact-sheet-president-s-plan-make-college-more-affordable-better-bargain->

⁴¹ Slack, Megan. "Income Based Repayment: Everything You Need to Know." The White House Blog, June 7, 2012, <http://www.whitehouse.gov/blog/2012/06/07/income-based-repayment-everything-you-need-know>.

implementation of a College Scorecard to hold colleges accountable for cost and to help families navigate through the trove of information allowing them to make better choices about college selection.⁴² In addition, the president has advocated for reforming student aid by adopting a plan that would “shift aid from colleges that fail to keep net tuition down and provide more aid to those colleges that provide good value.”⁴³

Congress

Congressional activity for addressing student loan reform has been considerable and this issue is likely to receive more attention as the November election draws nearer. Based on last summer’s squabbling over the interest rate legislation, the HEA reauthorization debate will be possibly more intense as both sides strive to win favor with major sect of their constituency: student loan borrowers.

The Senate

A democratic-led Senate will likely prove more supportive of President Obama’s education reform agenda. Chairman of the Senate HELP Committee, Thomas Harkin (D-IA), and Sen. Elizabeth Warren (D-Mass) have been long-time advocates for student loan borrowers and have both suggested ways for dealing with the student loan burden faced by many middle class families.

Sen. Richard Durbin (D-IL) introduced the Fairness for Struggling Students Act of 2013 which would reverse the 2005 Bankruptcy Abuse Prevention and Consumer Protection Act which made it so that all (federal and private) student loans were not

⁴² The White House. Issues: Higher Education - College Scorecard.

<http://www.whitehouse.gov/issues/education/higher-education/college-score-card>.

⁴³ The White House. Issues: Higher Education. <http://www.whitehouse.gov/issues/education/higher-education>.

dischargeable in bankruptcy. Currently this bill has little traction with 14 cosponsors and only a 10% chance of making it out of the Senate Judiciary Committee.⁴⁴

The House of Representatives

House Republicans will undoubtedly be President Obama's greatest opponent and Chairman of the House Committee on Education and the Workforce, Rep. John Kline (R-Minn.), has already expressed concerns over the president's proposed college ranking system. In preparing for the HEA reauthorization, the Committee has stated that they are finding themselves "at a crossroads between accountability and limited government."⁴⁵

Rep. Steve Cohen (D-TN) has introduced a bill complimentary to Sen. Durbin's in the House Judiciary Committee. Rep. Cohen's bill also aims to reverse the 2005 Bankruptcy Abuse Prevention and Consumer Protection Act and has 39 cosponsors with little to no chance of making it out of committee.⁴⁶

U.S. Department of Education

Education Secretary Arne Duncan is optimistic about the Administration's ability to positively impact student loans, but acknowledged that there is still much work left to be done.⁴⁷ In a press release issued last fall, Secretary Duncan commented that "the growing number of students who have defaulted on their federal student loans is

⁴⁴ Govtrack.us. S.114: Fairness for Struggling Students Act of 2013.

⁴⁵ House Education and the Workforce Committee, Press Release. "Preparing for Higher Education Act Reauthorization, Subcommittee Explores the Role of Federal Student Aid." April 16, 2013, <http://edworkforce.house.gov/news/documentsingle.aspx?DocumentID=329232>.

⁴⁶ Govtrack.us. H.R.532: Private Student Loan Bankruptcy Fairness Act of 2013.

⁴⁷ The U.S. Department of Education, Press Office. "Statement by Secretary Arne Duncan on Student Loans." (07/24/13). <https://www.ed.gov/news/press-releases/statement-secretary-arne-duncan-student-loans>.

troubling.”⁴⁸ However, he reaffirmed his Department’s commitments to the public that he will work “to improve college affordability for millions of students and families.”⁴⁹

The DoED was scheduled to begin contacting borrowers in October of last year to be sure they were aware of new options being offered to help with repaying student loans. Secretary Duncan has acknowledged that the challenge is getting the message out to those who may be suffering from the burden of student loan debt.⁵⁰

Recently the DoED has come under fire for the \$51 billion in profits made from student loan debt interest in 2013.⁵¹ With the DoED earning more than the nation’s most profitable company, Exxon Mobil, the White House has taken a greater interest in student loan issues. Increased public and media concern over this figure and the growing student loan debt crisis will keep the DoED in the spotlight for the foreseeable future.

Consumer Financial Protection Bureau

Established in 2010 as part of the Frank-Dodd Wall Street Reform and Consumer Protection Act, the Consumer Financial Protection Bureau (CFPB) mission is to look out for consumers’ best interest by ensuring the public has access to information that will allow them to make informed financial decisions. The CFPB has been a champion for student loan borrowers and has expressed concern over the growing student debt levels and its long-term effects on the economy. The CFPB’s Student Loan Ombudsman, Rohit Chopra, stated that “excessive student loan debt can slow the recovery of the housing market because student loan borrowers are sending big payments every month to their

⁴⁸ The U.S. Department of Education, Press Office. “Default Rates Continue to Rise for Federal Student Loans.” (09/30/13). <https://www.ed.gov/news/press-releases/default-rates-continue-rise-federal-student-loans>.

⁴⁹ Ibid.

⁵⁰ Lewin, Tamar. “U.S. to Contact Borrowers with New Options for Repaying Student Loans.” *The New York Times*, September 24, 2013, <http://www.nytimes.com/2013/09/25/education/us-to-contact-borrowers-with-new-options-for-repaying-student-loans.html?pagewanted=all>.

⁵¹ Nasiripour, Shahien. “Arne Duncan Signals Worry over Student Debt Levels.” *The Huffington Post*, May 21, 2013, http://www.huffingtonpost.com/2013/05/21/arne-duncan-student-debt_n_3315367.html.

loan servicers, rather than becoming first-time homebuyers.”⁵² Chopra further commented that the rising educational debt “may prove to be one of the more painful aftershocks of the Great Recession.”⁵³

Last year the Senate Committee on Financial Services commended the CFPB in a written statement for their “continued research and analysis into the consequences of student loan debt in the economy.”⁵⁴ The CFPB is the regulatory watchdog for consumers and will likely be more vocal than ever as the HEA reauthorization heats up.

The Federal Reserve Bank of New York

The Federal Reserve Bank of New York issued a report in 2013 that highlighted the effects of young adults’ economic activity in relation to the student loan debt. The report found that since the recession, home ownership among those with student loan debt has declined. In 2012, for the first time in ten years, home ownership among those young adults with no student loan debt surpassed those with student loan debt by two percentage points. Similar findings were discovered when analyzing student debt and vehicle purchases. These trends seem to indicate that young adults with educational debt are not consuming as in years past and this could perhaps have some correlation to student loan debt.

The State Governments

State governments appear to be leading the efforts on student loan reform and implementing measures that would provide greater transparency to student loan

⁵² The U.S. Department of Education, Press Office. Default Rates Continue to Rise for Federal Student Loans. 09/30/13. <https://www.ed.gov/news/press-releases/default-rates-continue-rise-federal-student-loans>.

⁵³ El Boghdady, Dina. “Student Debt May Hurt Housing Recovery by Hampering First-Time Buyers.” *The Washington Post*, February 2, 2014, http://www.washingtonpost.com/business/economy/student-debt-may-hurt-housing-recovery-by-hampering-first-time-buyers/2014/02/17/d90c7c1e-94bf-11e3-83b9-1f024193bb84_story.html

⁵⁴ House Committee on Financial Services, Press Release. “Miller, Waters Pledge Action on Private Student Loan Debt.” 05/09/13. <http://democrats.financialservices.house.gov/press/PRArticle.aspx?NewsID=1546>.

borrowers. Several states have started to enforce a performance-based funding formula that would tie college performance directly to state funding, fostering accountability among higher education institutions.

The National Governors Association spokesman, Travis Reindl, testified last fall before the House Education and the Workforce Committee asking that the federal government support state's efforts to "promote better accountability, transparency, and reduce redundancies and administrative costs" by "streamlining and coordinating regulations across federally funded programs."⁵⁵

V. Policy Proposal:

This proposal recommends that Title IV of the 2014 Higher Education Act be amended to allow for student loans to be dischargeable through bankruptcy without the added burden of an adversary proceeding.

For the most distressed borrowers, not even bankruptcy offers relief from student loan debt. Income-based repayment plans, College Scorecards, and reduced interest rates do not apply to those who are already burdened with education debt. Default rates are steadily climbing and a slow economic recovery has only exacerbated the problem. This group of borrowers should not be overlooked as Congress deliberates amendments to the 2014 HEA. This proposal advocates for the repeal of §523(a)(8) Title 11 of the United States Code which would allow for the discharge of student loan debt, both public and private, regardless of loan date.

Further, this proposal recommends that borrowers be eligible to dismiss student loan debt after the loans have been in repayment for a minimum period of seven years. This period should exclude any time the loan may have spent in deferment or forbearance.

⁵⁵ Travis Reindl, "Transparency in Higher Education" (Testimony before the House Education and the Workforce Committee Subcommittee on Higher Education and Workforce Training, April 24, 2013).

Seven years should give the borrower time to find stable employment and build equity, which would enable the borrower to repay his or her student loans.

The Judiciary will continue to be responsible for determining if the borrower is eligible for bankruptcy and this proposal does not seek to amend the bankruptcy proceedings themselves. This proposal simply recommends repealing language that currently bars student loan borrowers from being able to absolve their loans through a court-adjudicated bankruptcy proceeding.

Current legislation under consideration in Congress only addresses discharging private student loans in bankruptcy, but seeing as how this type of loan debt only accounts for approximately 10 percent of the total amount of student loan debt, it would be beneficial to address both public and private loans.⁵⁶ By permitting educational loans to be absolved in bankruptcy, you are addressing an immediate economic problem that will provide the most encumbered families with much needed reprieve. As written today, §523(a)(8) requires borrowers to demonstrate an “undue hardship” which is not only excessively burdensome, but according to most reports is applied inconsistently by the courts.⁵⁷ By eliminating this provision, debtors will have a fair opportunity at fresh start through bankruptcy.

The reauthorization of the HEA provides Congress with the perfect opportunity to implement revisions to the current student loan program and address the growing burden faced by many borrowers. The HEA will be the authorizing mechanism that Congress will use to repeal §523(a)(8) of the Bankruptcy Code.

⁵⁶ Freedman, Josh. “Risky Business: Why Student Loans are the Worst Way to Fund College.” *Forbes*, February 10, 2014.

⁵⁷ Valenti, Joe and David Bergeron. “How Qualified Student Loans Could Protect Borrowers and Taxpayers.” Center for American Progress, August 20, 2013, <http://www.americanprogress.org/wp-content/uploads/2013/08/QualifiedStudentLoansCC.pdf>.

VI. Policy Analysis:

Disadvantages

This policy recommendation does not address the student debt crisis in its entirety. Repealing §523(a)(8) and reversing the 2005 BAPCPA would only positively impact those borrowers who have incurred a significant amount of loan debt and who qualify for bankruptcy protection. In reality, this may be a very small percentage of borrowers since no recent empirical data exists to tell how many families who file for bankruptcy actually have student loan debts. We do know that in 2007, 29 percent of consumers filing for bankruptcy held educational debt.⁵⁸ One can infer that since bankruptcy filings increased in the years immediately following the Great Recession and student loan borrowing has also drastically climbed, the percentage of those filing for bankruptcy with student loan debt is likely to have increased. Without a more precise or current measurement, one cannot be certain of the full impact this policy prescription, therefore making it difficult to determine the efficacy of this proposal.

When Congress first added §523(a)(8) to the Bankruptcy Code in the late 1970s, lawmakers were concerned that allowing education loan debts to be discharged through bankruptcy would foster abuse and ultimately undermine the student loan system. In addition, supporters of §523(a)(8) argue if the “undue hardship rule was repealed or enacted too leniently, the Federal Student Loan Program could collapse and lenders would refuse to approve loans for high-credit-risk students.”⁵⁹ Undoing this law today runs the same risk that legislators were concerned about decades ago. Understating the long-term repercussions of bankruptcy may be difficult for younger generations and

⁵⁸ "Ending Student Loan Exceptionalism: The Case for Risk-Based Pricing and Dischargeability." *Harvard Law Review* 126, no. 2 (December 2012): 587-610. *Business Source Complete*, EBSCOhost (accessed March 10, 2014).

⁵⁹ Grant, Kyle. “Student Loans in Bankruptcy and the ‘Undue Hardship Exception’ Who Should Foot the Bill?” *Brigham Young University Law Review* (September 2011): 819-847.

bankruptcy may be viewed as a quick alternative to paying back thousands in educational debt. In other words, bankruptcy could be perceived as the “easy way out” for some.

Should this policy proposal be implemented, the banks would likely be more cautious about who they lend to. As a possible unintended consequence, students who pose a greater financial risk could be less likely to obtain educational loans or be subjected to a significantly higher interest rate. This pool of borrowers may in turn have a limited school selection as they would not have adequate funding to fully finance their education, making some colleges out of reach. Many private lenders argue this was the reason for enacting the 2005 BAPCPA in the first place. According to this group, the legislation was necessary in order to “offer loans to a broader spectrum of students, including those with lower credit scores.”⁶⁰ As President Obama encourages college affordability for all, it is important to weigh this unintentional outcome when considering this policy proposal.

Advantages

With a \$1.2 trillion price tag, student loan debt has surpassed all other types of household debt, with the exception of home mortgages. This loan debt could be a contributing factor to the slow economic recovery as young adults are overwhelmed with student loan repayments and reluctant to take on additional debt. Permitting student loans to be absolved through bankruptcy would reduce overall indebtedness and lower

⁶⁰ Fuller, Andrea. “Lawmakers Introduce Bills to Change Student-Loan Bankruptcy Policy.” *The Chronicle of Higher Education*, April 22, 2010, <http://chronicle.com/article/Lawmakers-Introduce-Bills-t/65217/>.

the number of defaults. Since the implementation of the 2005 BAPCPA, delinquency rates on repayments have doubled.⁶¹

No current statistics or empirical evidence exists to measure the exact number of people this policy would help. However, recent trends indicate that the percentage of college graduates filing for bankruptcy is increasing. A study conducted by the Institute for Financial Literacy found that “College graduates are the fastest-growing group of consumers who have filed for bankruptcy protection in the past five years.”⁶²

Unfortunately, this group of consumers was not able to easily use bankruptcy protection to relieve this debt, which likely stifled their ability to recover financially. Assuming their bankruptcy is granted by the court, this policy proposal would directly impact this group of debtors by eliminating or significantly reducing their student loan debt.

The purpose of bankruptcy is to give debtors a second chance and §523(a)(8) is in direct conflict with bankruptcy’s primary purpose. It seems irrational that the system discriminates when it comes to educational debts. Bankruptcy’s promise of a second chance would allow this group of individuals to enter back into consumerism. Borrowers should have access to the same protections as those who amassed up other unsecured debts. Sen. Elizabeth Warren put it best in her 2007 blog post “Why should students who are trying to finance an education be treated more harshly than someone...who racked up

⁶¹ Touryalai, Halah. “More Evidence on the Student Debt Crisis: Average Grad’s Loan Jumps to \$27,000.” *Forbes*, January 29, 2013, <http://www.forbes.com/sites/halahtouryalai/2013/01/29/more-evidence-on-the-student-debt-crisis-average-grads-loan-jumps-to-27000/>.

⁶² Mui, Ylan Q. “Study: College Graduates Driving Increase in Bankruptcy Filings.” *The Washington Post*, September 12, 2011, http://www.washingtonpost.com/business/economy/study-college-graduates-driving-increase-in-bankruptcy-filings/2011/09/12/gIQAmeMtNK_story.html.

tens of thousands of dollars gambling?”⁶³ Students should not be held to the same standards as a criminal just for taking out student loans.

While potential abuse of the system is certainly a valid concern, a 1977 General Accounting Office (GAO) study analyzed the bankruptcy filings of student loan borrowers prior these reforms and found that “only 8 percent of bankruptcy filers with student loans had no other debt.”⁶⁴ This study implies that prior to the tightened bankruptcy controls enforced by Congress borrowers did not appear to be taking advantage of the system. The National Bankruptcy Review Commission, which was required to generate a report of recommendations on the Bankruptcy Code in 1997, “advised that the discharge ability exception be repealed” stating there “was no evidence that the bankruptcy systems had been abused when student loans were more easily dischargeable.”⁶⁵ This report compliments the 1977 GAO report and further illustrates that the perceived risk of abuse is perhaps just that, a perception. This evidence provides policymakers with the rebuttal they need to counter critics who think repealing §523(a)(8) would undermine the educational loan system.

The Obama Administration has been working to improve the student loan system with the College Scorecard, the income based repayment plan, and other initiatives. As noted earlier, these new programs are not retroactive to assist those who have already taken on the debt and therefore leave a very important group out of the relief discussion. An income based repayment plan does little for someone who cannot secure a job and a

⁶³ Warren, Elizabeth. “Student Loan Scandal Fallout.” Credit Slips Blog, June 3, 2007, http://www.creditslips.org/creditslips/2007/06/student_loan_sc.html.

⁶⁴Valenti, Joe and David Bergeron. “How Qualified Student Loans Could Protect Borrowers and Taxpayers.”

⁶⁵ “Ending Student Loan Exceptionalism: The Case for Risk-Based Pricing and Dischargeability.” *Harvard Law Review* 126, no. 2 (December 2012): 597

College Scorecard is not going to be helpful for someone who has already graduated and is facing a mountain of debt. This policy prescription would directly aid those borrowers who are often overlooked in the policy discussion and yet have the direst economic situation. Amending the Bankruptcy Code to allow for more deserving families to get economic relief is key to helping those who will not see reprieve through the Administration's new initiatives.

Finally, a recent article published in the *American Bankruptcy Law Journal* found that the true flaw in the bankruptcy system is that "debtors are not informed about the actual working of the discharge process" and therefore are unlikely pursue the adversary proceeding that is required for consideration of the dismissal of student loans.⁶⁶ In fact, the empirical study found that only 0.1 percent of student loan borrowers in bankruptcy actually file for the adversary proceeding.⁶⁷ Retracting §523(a)(8) from the Bankruptcy Code would eliminate the need for the adversary proceeding and doing so would mean that consumers would not have to rely on obtaining an expensive bankruptcy attorney to help them navigate the intricacies of student loan bankruptcy. There is clearly an information deficit when it comes to educating the most distressed borrowers about their financial options.

The fee just to file for bankruptcy can range from \$281-\$306⁶⁸ and a 2012 GAO study found that the administrative fees have been increasing since implementation of the

⁶⁶ Iuliano, Jason. "An Empirical Assessment of Student Loan Discharges and the Undue Hardship Standard." *American Bankruptcy Law Journal* 86, no. 3 (Summer 2012): 523.

⁶⁷ Ibid.

⁶⁸ United States Bankruptcy Court, Bankruptcy Court Fee Schedule.
<http://www.canb.uscourts.gov/bankruptcy-court-fee-schedule>.

2005 BAPCPA.⁶⁹ These fees are in addition to the costs associated with hiring a bankruptcy attorney (averages about \$1500⁷⁰) and for someone who's already facing bankruptcy, these costs are just too great. Adopting this policy proposal would allow student loan debt to be treated like all other unsecured debts and eliminate the costly adversary proceeding currently required under law.

Cost Analysis

When examining the efficiency of this proposal, it is unclear as to what the costs would be in comparison to the expected benefits to borrowers. According to one study, the "undue hardship" requirement in §523(a)(8) saves the taxpayer \$4 billion annually.⁷¹ If borrowers were permitted to discharge their loans through bankruptcy, it is doubtful that the economy would see an immediate \$4 billion boost, which could be perceived as a failure by some critics. Adding this additional financial burden to taxpayers is unlikely to have the desired economic effect, as the burden would only be shifted to the public at-large. Since the government dispenses the federal loans and backs most private student loans, the government would certainly see a loss if §523(a)(8) were to be reversed. In this case, it is difficult to determine if the possible cost to the government and taxpayers would be worth the projected benefit to borrowers.

The actual cost of this policy prescription is fairly uncertain. While researchers have asserted that the undue hardship clause saves American taxpayers a significant amount of money, these reports neglect to mention the extreme profits the Department of

⁶⁹ Dugas, Christine. "Tax Refunds Being Used to Pay for Bankruptcy Filings." *USA Today Money Online*, April 13, 2012, <http://usatoday30.usatoday.com/money/perfi/taxes/story/2012-04-12/tax-refund-filing-for-bankruptcy/54227664/1>.

⁷⁰ Ellis, Blake. "Too Broke to Go Bankrupt." *CNN Money Online*, May 7, 2012, <http://money.cnn.com/2012/05/07/pf/bankruptcy-costs/>.

⁷¹ Iuliano, Jason. 2012. "An Empirical Assessment of Student Loan Discharges and the Undue Hardship Standard." *American Bankruptcy Law Journal* 86, no. 3: 524. *Business Source Complete*, EBSCOhost (accessed March 12, 2014).

Education enjoys off student loans.⁷² In fiscal year 2013, the government made over \$40 billion on loan debts and in 2011 spent \$1.4 billion to collect unpaid debts from borrowers.⁷³ Government officials have said that these profits made on interest already go toward offsetting the cost of federal loans currently in default.⁷⁴ By allowing these borrowers to seek discharge through bankruptcy, there would likely be fewer defaults, which would make it possible to use some of these profits to help offset any negative financial effects that taxpayers may have as a direct result of repealing §523(a)(8). This would help to prevent any shift in economic burden from the government to the taxpayer.

VII. Political Analysis:

In another attempt to reverse the 2005 BAPCPA, Senator Richard “Dick” Durbin (D-IL) has introduced the “Fairness for Struggling Student Act of 2013” (S.114). This newly proposed legislation is similar to his earlier legislative efforts to reform the student loan system. This bill seeks to amend the bankruptcy code and reestablish dischargeability for private student loans through bankruptcy. It was said that the “enactment of the legislation would have constituted a unique push-back against the lender lobby, the kind that would have robustly championed the plight of student-loan borrowers.”⁷⁵ Unfortunately, Sen. Durbin has yet to see his efforts come to fruition. His 2007 bill was said to have ultimately failed as a result of the clever lobbying tactics put forth by the banking industry.⁷⁶

⁷² Ibid.

⁷³ Jesse, David. “Government Books \$41.3 Billion in Student Loan Profits.” *USA Today*, November 25, 2013, <http://www.usatoday.com/story/news/nation/2013/11/25/federal-student-loan-profit/3696009/>.

⁷⁴ Roger, Kate. “Default Rates Climb for Student Loans: Who Pays?” *Fox News Online*, January 24, 2011, <http://www.foxbusiness.com/personal-finance/2011/01/24/default-student-loans-pays/>.

⁷⁵ Pardo, Rafael I., and Michelle R. Lacey. “The Real Student-Loan Scandal: Hardship Discharge Litigation.” *American Bankruptcy Law Journal* 83, no. 1 (Winter 2009): 179-235. *Business Source Complete*, EBSCOhost (accessed March 24, 2014).

⁷⁶ Ibid.

Rep. Steve Cohen's (D-TN) bill is the House counterpart to Sen. Durbin's legislation. Rep. Cohen released this statement about his legislation "Congress taking action on student loan debt is long overdue...the bankruptcy system should work as a safety net that allows people to get the education they want with the same assurance that, should their finances come under strain by **layoffs, accidents, or other unforeseen life events, they will be protected. Our bill takes a modest but important step in achieving this goal.**"⁷⁷ **Rep. Cohen's proposed bill, while unlikely to make it out of the Senate Judiciary Committee, has seen a small surge in co-sponsors this year.**⁷⁸ **This could imply that more members of Congress are taking interest in the issue and perhaps revisiting the current rules surrounding student loans and bankruptcy.**

It is important to note that these proposed bills do not challenge the bankruptcy requirement for federally funded loans and therefore are likely to be considered be less conversional. However, both bills are still unlikely to make it out of their respective Judiciary Committees. This recommendation calls for the not only the ability to discharge private loans, but federal loans as well. If the projected success for these two bills is any indication of the success of this policy proposal, then it is improbable that Congress will reach any agreement on amending or repealing §523(a)(8).

However, there has been noticeable movement on Capitol Hill to address student loan debt in general. Momentum and visibility have been growing on the issue and several pieces of legislation have been introduced to try to address the growing problem. Sen. Durbin has also introduced his "Student Loan Borrower Bill of Rights" (S. 1803),

⁷⁷ Congressman Steve Cohen, Media Center, Press Releases. "Cohen/Davis Introduce Legislation to Restore Fairness in Student Lending." February 6, 2013, <https://cohen.house.gov/press-release/cohendavis-introduce-legislation-restore-fairness-student-lending>.

⁷⁸ Govtrack.us. H.R.532: Private Student Loan Bankruptcy Fairness Act of 2013.

which offers six fundamental rights for student loan borrowers including “the right to fairness, like grace periods when loans are transferred or debt cancellation when the borrower dies or becomes disabled.”⁷⁹ During a Senate HELP Committee hearing on “Strengthening the Federal Loan Program for Borrowers,” Sen. Durbin provided testimony and an overview of his “Student Loan Borrower Bill of Rights.” During his testimony Sen. Durbin emphasized the need to address the bankruptcy issue by asserting “student loans will literally follow you your entire life until you pay it off...that’s just not fair when you consider all the other debts that are dischargeable in bankruptcy.”⁸⁰

The Consumer Financial Protection Bureau supports amending the Bankruptcy Code to allow for student loans to be discharged under bankruptcy. Director Richard Cordray recently testified to the House Committee on Financial Services that in the last year the CFPB has received thousands of complaints about private student loans and almost 30,000 responses to a request for comments regarding the effect of educational debt of consumers and the broader economy.⁸¹ Director Cordray has publically questioned the efficacy the 2005 BAPCPA by stating that “the law doesn’t appear to have met its objectives of bringing down borrowing costs and expanding access to private loans.”⁸² He went on to say “it would be prudent to consider whether they wish to

⁷⁹ “Durbin Introduces Student Loan Borrower Bill of Rights.” December 3, 2013, <http://www.durbin.senate.gov/public/index.cfm/pressreleases?ID=9b39e962-ea0f-4120-995c-48fcb19106be>.

⁸⁰ “Senator Durbin Statement Following Senate Hearing on Student Loans.” March 27, 2014, <http://www.eneuspf.com/latest-news/school-news/51464-senator-durbin-statement-following-senate-hearing-on-student-loans-march-27-2014.html>.

⁸¹ Cordray, Richard. “Written Testimony of CFPB Director Richard Cordray Before the House Committee on Financial Services.” January 27, 2014, <http://www.consumerfinance.gov/newsroom/written-testimony-of-cfpb-director-richard-cordray-before-the-house-committee-on-financial-services/>.

⁸² Mitchell, Josh. “Obama Administration Backs Bankruptcy Option for Some Student Debt.” *The Wall Street Journal*, July 20, 2012, <http://online.wsj.com/news/articles/SB10000872396390444097904577537390098445700>.

modify the code in light of the impact on young borrowers in challenging labor-market conditions.”⁸³

This policy proposal will be unpopular with the banking and lending industry as permitting private educational loans to be absolved in bankruptcy would likely result in a loss for these companies. This could also be seen as setting or maintaining a precedent for annulling other creditors’ investments. Any efforts to implement a reversal or amendment in current bankruptcy law will likely be met with a heavy and powerful lobby led by lending giants, such as Sallie Mae. Sallie Mae made \$2.5 billion on student loan interest in 2012.⁸⁴ Leading up to the Health Care and Education Reconciliation Act of 2010, which made the federal government the primary lender of student loans, opponents called the plan a “federal takeover” and enjoyed support from fiscal conservatives and Republicans. From 2007-2013, Sallie Mae spent \$22.74 million in federal lobbying; and in 2009 gave \$194,000 in political contributions in an effort to challenge the passage of the legislation.⁸⁵ Sallie Mae claimed this bill would force it to cut 2,500 jobs at time when “the country can least afford to lose them.”⁸⁶ As demonstrated in years past, an anticipated heavy opposition by the financial lobby will likely sway many Republicans and fiscal conservatives from supporting this policy proposal.

The banking industry is likely to discourage adoption of such a policy as banks are being faced with an increase in the number of student loan write-offs. According to

⁸³ Ibid.

⁸⁴ Schroeder, Peter. “Sen. Warren Spars With Student Lender Sallie Mae Over Loan Rates.” *The Hill*, June 30, 2013, <http://thehill.com/blogs/on-the-money/banking-financial-institutions/308519-sen-warren-spars-with-sallie-mae-on-student-loan-rates>.

⁸⁵ Lichtblau, Eric. “Lobbying Imperils Overhaul of Student Loans.” *The New York Times*, February 4, 2010, <http://www.nytimes.com/2010/02/05/us/politics/05loans.html?pagewanted=all&r=0>.

⁸⁶ Anderson, Nick. “Students Push for Aid Overhaul; Lenders Lobby Against It.” *The Washington Post*, March 24, 2010, <http://www.washingtonpost.com/wp-dyn/content/article/2010/03/23/AR2010032302231.html>.

data collected from Equifax, “Between January and August of last year, lenders wrote off \$13.6 billion in student loan debt, a 46 percent increase from the same period of 2012.”⁸⁷ These write-offs account for federal and private loans that have been sent to collections and for those who have filed for bankruptcy. As a result, many banks have ceased their student loan operations due to a lack of profit and heightened risk.⁸⁸ With fewer lenders participating in the student loan business, there is less incentive for the remaining banks to offer students loans with competitive interest rates and repayment options.

Based on the various studies and polls, public opinion on this policy proposal is likely to be split. According to a 2012 Pew Research Center poll, about half of those surveyed believed that the bulk of college costs should be financed by the federal government, state governments, private endowments or some combination.⁸⁹ This group of respondents is likely to be more receptive to a change in bankruptcy policy that would permit educational loans to be discharged. On the contrary, there are a growing number of individuals who are questioning the value of a college education. This group will be less likely to support this proposal because they may see this recommendation as creating an additional cost to them. People are less inclined to pay for something they don’t support in the first place.

Chairman of the House Committee on Financial Services, Jeb Hensarling (R-TX), has expressed concern over the nation’s unsustainable deficit and stands committed to

⁸⁷ Cumming, Chris. “Troubling Spike in Student Loan Write-Offs.” *American Banker*, January 2, 2014, http://www.americanbanker.com/magazine/124_01/worrisome-spike-in-student-loan-write-offs-1064197-1.html.

⁸⁸ Ibid.

⁸⁹ Pew Research Center. “Is College Worth It?” May 15, 2011, <http://www.pewsocialtrends.org/2011/05/15/is-college-worth-it/>.

ensuring less taxpayer money is at risk by creating market discipline.⁹⁰ While Chairman Hensarling has not directly addressed his views on student loan debt, he has made it clear that he sees this mounting debt as significant factor limiting first-time home buyers and thinks the price of education is artificially inflated. Given Chairman Hensarling's conservative budget views and caution around taxpayer dollars, it is unlikely that he would be supportive of a policy that may appear to shift the student debt burden onto taxpayers.

Politically speaking, this policy proposal is likely to be unpopular in a Republican-controlled House and Democrats may find it difficult to support such a drastic change in student loan policy. Similar legislation aimed at reforming the Bankruptcy Code in both the House and Senate has had little traction thus far and been met with political gridlock. Currently the Senate bill (S.114) has 14 cosponsors with 13 democrats and one independent signed on.⁹¹ The House bill (H.R. 532) has 39 democrat cosponsors.⁹² Since 2006 there have been ongoing congressional efforts to repeal §523(a)(8), but all attempts have been unsuccessful. President Obama has not taken a stance on this legislation, nor has he addressed this topic specifically. Without an ally at the White House, it is unlikely that President Obama will use his executive privilege to move this legislation along. Consequently, it is doubtful that this recommendation is politically feasible and would be successfully adopted into the 2014 HEA reauthorization bill.

⁹⁰ The Committee on Financial Services, Media, Press Releases. "Hensarling in the House: Jeb Hensarling Pushes Housing Reform Center State." September 9, 2013, <http://financialservices.house.gov/blog/?postid=348076>.

⁹¹ Govtrack.us. S.114: Fairness for Struggling Students Act of 2013.

⁹² Govtrack.us. H.R.532: Private Student Loan Bankruptcy Fairness Act of 2013.

VIII. Recommendation:

This policy proposal aims to use the upcoming HEA reauthorization as the means for amending the Bankruptcy Code making it so that student loans are discharged as part of any bankruptcy proceeding and treated the same as other forms of unsecured debt. The offered policy prescription does not conquer every shortcoming of the student loan program and the suggestion offered encompasses only a portion of a much larger issue. The goal of this proposal is rather to focus on helping a subset of the middle class manage the burden of student loan debt by offering financial options for distressed borrowers. While the compounding student loan debt crisis is a serious problem, it is a much more complex and far-reaching issue to address with any one policy prescription. Taking a bite out of the debt burden for the middle class will help stimulate the economy and possibly create jobs as the demand for goods and services grows.

There are several important downsides associated with supporting this proposal. Most glaringly, the analysis provided lacks a true understanding of the scope of who will be impacted by this recommendation. The 2007 metrics provided are dated and there have been no empirical studies conducted since then to show the effect such proposal would have on debtors or the economy at large. Without an in-depth understanding of the magnitude of borrowers who will benefit from amending the Bankruptcy Code, it will be difficult to gain any public or political support.

Secondly, the cost of this policy recommendation is still somewhat ambiguous. Allowing federally funded loans to be discharged through bankruptcy would likely mean the burden shifts to the taxpayer. This is problematic as this policy proposal aims to help jumpstart the economy through repealing the stringent bankruptcy language, not further tax the American people. However, the taxpayer is already paying for those federally

funded defaulted loans, so there may not be a significant difference in cost to the taxpayer. This is something that would need to be studied in greater depth to understand the true cost.

Given the above mentioned downsides, this policy proposal may not be quite ready for implementation. Instead, it is recommended that Congress use the HEA as the means for commissioning a government-sponsored, non-partisan study to validate the assertion that this policy would have a useful effect on the economy and positive effect on bankruptcy filers. Gathering this scientific data would allow the government more insight into the circumstances surrounding bankruptcy and provide greater understanding about the policy's broader economic implications. Funding for this analysis should be allocated to the Department of Education and could be financed from the interest made on the student loan program.

This policy proposal should be looked at a part of a larger strategy to tackle the growing student debt problem. Amending current Bankruptcy Code will not solve the student loan debt crisis, but it will be a crucial step in the right direction by allowing a frequently overlooked population of student loan borrowers access to a second chance. While unlikely to be politically viable, the proposal addresses a very key population and offers immediate relief for the most vulnerable of borrowers; and therefore should be thoroughly vetted as Congress considers the upcoming HEA reauthorization.