AccessLex INSTITUTE®

POLICY PROPOSAL:

Bankruptcy Discharge and Education Loans

AccessLex Institute proposes that education loans be considered on equal terms with other unsecured debt in a bankruptcy proceeding if the loan in question has been in repayment for at least seven years.

Prior to 1976, student loans, much like other forms of unsecured credit, were dischargeable in bankruptcy; but changes made over the last 40 years to the Bankruptcy Code have resulted in overly burdensome procedural and substantive hurdles to the discharge of student loans by borrowers. Today, a student loan borrower seeking discharge must engage in a separate adversary proceeding within the bankruptcy proceeding to prove that a student loan creates an "undue hardship" before a court may order full or partial discharge of such loans.

The resulting policy changes, as applied, fail to live up to the promise of a "fresh start" imagined by the bankruptcy code. Bankruptcy judges, due to legislative changes subsequent to the adoption of the undue hardship test, continue to apply a standard for relief that considers a borrower's full remaining repayment period (which could span decades) even though that standard was intended to apply only during a limited waiting period. Many, including scholars and commentators in this field, have found application of the current standard to result in arbitrary, random and sometimes, seemingly unfair results. As a result of these hurdles, it is estimated that a mere 0.3 percent of student loan debtors in bankruptcy cases even seek to have their educational debts discharged.

Changes to the Treatment of Education Loans in Bankruptcy

1976	Higher Education Act (HEA) amended to provide that Federal student loans must be in repayment for at least 5 years to be eligible for discharge in bankruptcy, absent a showing of undue hardship
1978	Bankruptcy Code amended to provide that loans from governmental units or nonprofit institutions of higher education may not be discharged prior to the expiration of the 5-year waiting period, except upon a showing of undue hardship
1979	Education loans guaranteed or insured pursuant to HEA are added to those covered by the nondischargeability provisions; periods of deferment and forbearance deemed to suspend the 5 year waiting period extended to all covered loans
1984	Private, credit-based education loans made by nonprofit entities, including state-affiliates, are added to those covered by the nondischargeability provisions
1990	Waiting period increased to 7 years
1998	Waiting period is eliminated, requiring a showing of undue hardship no matter how long a loan has been in repayment
2005	Private, credit-based education loans made by taxable entities are added to those covered by the nondischargeability provisions

AccessLex Institute Proposal

As a nonprofit holder of both Federally-guaranteed and private, credit-based education loans, AccessLex Institute has long advocated for responsible borrowing, offered quality counseling and other relevant and timely information to student borrowers, and encouraged diligent repayment by borrowers. However, AccessLex Institute recognizes that the fresh start afforded through bankruptcy may be the most appropriate choice for student loan borrowers in financial distress and should be more accessible under certain circumstances.

Therefore, AccessLex Institute believes that it is time to better align the treatment of education loans with the sound public policy that supports bankruptcy relief in general by restoring reasonable and efficient opportunities in certain instances for full or partial discharge of education loans.

Specifically, AccessLex Institute proposes that education loans be considered on equal terms with other unsecured debt in a bankruptcy proceeding if the loan in question has been in repayment for at least seven years (exclusive of deferments or mandatory forbearances).

The current statutory framework and applicable undue hardship requirements would continue to apply to student loans:

- In repayment less than 7 years;
- Owed by a borrower who had sought and been granted discharge of any student loan amount in a previous bankruptcy proceeding; or,
- Eligible to participate in an income-driven repayment plan that provides for monthly payments no greater than 15% of discretionary income with the possibility of loan forgiveness after no longer than 25 years.

AccessLex Institute believes that this proposal sufficiently recognizes the unique nature of student loan debt, and properly balances the interests of various stakeholders, eliminating any opportunity for serial use of bankruptcy as a substitute student loan repayment plan and maintaining its focus as a last resort option for those truly in need.

Questions about AccessLex Institute's proposal may be directed to Nancy Conneely, Managing Director of Policy, at nconneely@accesslex.org or (484) 653-3416.

About AccessLex Institute: AccessLex Institute is a nonprofit organization committed to helping talented, purpose-driven students find their path from aspiring lawyer to fulfilled professional. In partnership with our nearly 200 Member law schools, improving access and positively influencing legal education have been at the heart of our Company's mission since 1983.

Through the work of the AccessLex Center for Legal Education Excellence, we advocate for policies that make legal education work better for students and society alike, and conduct research on the most critical issues facing legal education today: improving access for all students, with an emphasis on historically underrepresented minority students and students from economically disadvantaged backgrounds; increasing affordability; and strengthening the value of a legal degree.

The AccessLex Center for Education and Financial Capability offers on-campus and online financial education programming and resources to help students confidently manage their finances on their way to achieving personal and professional success. This Center also provides professional development opportunities and guidance for school administrators working to improve financial education at their institutions.