

The Student Loan Solution

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Recently, news stories, political pundits, social media outlets and the talking heads have become keenly aware of the growing danger imposed by burgeoning student loan debt and the economic chaos it has caused and will continue to cause. Although the crisis appears to dominate our cell phones and news feeds, bankruptcy professionals involved in consumer bankruptcy matters are fully aware that the student loan problem is growing and has the potential to drag down an entire generation.

The use of student loans to finance a higher education and the outstanding balances on such student loans has exploded. In fiscal year 2007, figures revealed \$516 billion in outstanding student loans owed by 28.3 million borrowers. That has blossomed to \$1.6 trillion owed by 42.8 million borrowers by 2021.¹ The average student loan debt per borrower is roughly \$35,000.² Over a third of individuals with any type of debt have student loan debt.³ Six percent of borrowers owe more than \$100,000 in debt with 2% owing more than \$200,000. This 6% owe one-third of the outstanding \$1.6 trillion in debt. Interestingly, 18% of borrowers owe less than \$5,000 in student loan debt but collectively owe 1% of the outstanding debt.

The Brookings Institution found that individuals who owe the most are not the individuals who default on their debt. While graduate degree borrowers have the highest outstanding balances of student loans, they possess the lowest default rates despite accounting for about half of all student loan debt. Not surprisingly, higher default rates are most common for students who went to for-profit institutions.⁴

Student loan debt is the second largest type of consumer debt. Second only to mortgage debt.⁵ Even automobile loans, formerly the crown prince of consumer debt, has been outstripped by the student loan epidemic.⁶ It also does not appear that this problem will end soon. In one year alone, 2020 to 2021, students received \$84 billion in new federal loans.⁷

Recently, the intelligentsia has gotten interested in the student loan problem. Recognizing that the burden imposed on borrowers by student loans, so easy to obtain and so hard to repay, is having an impact beyond that of ordinary debt.

Economics experts are discovering that the burgeoning student loan debt could easily slow economic growth, preventing student loan borrowers from fully participating in the American economy. Studies have shown that the increase in student loans correlates with slower growth of

¹ See Federal Student Aid Portfolio Summary. [Studentaid.gov/data-center/student/portfolio](https://studentaid.gov/data-center/student/portfolio) visited September 25, 2022.

² See mint.intuit.com/blog/student-finances/student-loan-debt-statistics last visited September 25, 2022.

³ *Id.*

⁴ See brookings.edu/blog/up-front/2019/11/12/5-facts-about-student-loans last visited September 25, 2022.

⁵ See [Experian.com/blogs/ask-experian-research-consumer-debt-study](https://experian.com/blogs/ask-experian-research-consumer-debt-study).

⁶ The Board of Governors of the Federal Reserve System indicate that there was \$1,748,254,000 of outstanding student loan debt and outstanding automobile debt was \$1,363,937,000.

⁷ See research.collegeboard.org/media/pdf/trends-college-pricing-student-aid-2021.pdf.

new businesses, lower rates of homeownership, increasing stress in times of emergency, suppresses consumer spending, and delays traditional life milestones.⁸

Those of us involved in consumer bankruptcy have seen, not simply an inability to satisfy student loans, but frustration and lack of a visible, understandable, path to relief from the student loan quagmire. It is the inability to achieve any progress in paying student loan debt that has created the frustration and sense of hopelessness that has disheartened an entire generation.

Professionals dealing with student loan borrowers know that student loan repayment programs, such as income debt repayments (IDR), public service debt forgiveness (PSLF) are confusing, misleading, unpredictable, unclear, and frustrating. Such a lack of clarity leads to a lack of confidence and fairness in these systems. Don't we owe borrowers a prospect of light at the end of tunnel?

The President has proposed an across-the-board federal student loan forgiveness of \$10,000 or \$20,000 for PELL grant recipients which could eliminate student loans for a broad tranche of borrowers - and no need for statutory change – only a change in policy by the Department of Education. Given the lukewarm acceptance of the President's debt forgiveness program, not to mention the tremendous cost of debt forgiveness, it is time for the problem to be addressed in a manner that is feasible and easy to administer. In our small corner of the world – consumer bankruptcy – lighting a lamp at the end of the tunnel is not only possible, it creates a fair and balanced escape route. Now is the time for bankruptcy professionals to step up.

As a long-serving bankruptcy trustee, I have examined this issue for many years and have come to the conclusion that any comprehensive solution is decades in the future, requiring reexamination of the costs of education, the method of underwriting, and the education of our work force. However, I believe there is a way Chapter 13 can provide a vehicle to facilitate the Department of Education, the trustee community, the consumer bar and the judiciary to craft a solution that will provide light in that dark tunnel. Within the limits of Chapter 13, without the necessity of Congressional intervention, there is a solution to give student loan debtors the ability to pay the best they can for a ten-year period.

My proposal is modest and outlined as follows:

1. The Department of Education should recognize that it is a hardship for a borrower whose income is principally derived from Social Security Disability to repay any student loan and such should be subject to a bankruptcy discharge. The DOE should presume that it would be an unreasonable hardship for a borrower who has been recognized as eligible for Social Security Disability to repay a student loan.
2. The Department of Education should acknowledge and presume that it is a hardship for an individual whose taxable income in the previous two tax years totaled less than 175% of the poverty level in the United States to repay the student loan. Certainly,

⁸ Researchers have discovered that traveling, saving for retirement, improving friendships, moving, getting married, having a baby, starting a business have all been deferred as a result of student loan burdens. See Kirkham, Elyssa studentloanhero.com/featured/effects-of-student-loan-debt-usa-economy last visited September 25, 2022.

where an individual now has substantial increase in income, the Department of Education can challenge such a presumption. However, for the typical debtor who has income at or below 175% of the poverty level, it is not a far stretch to simply state that a hardship will be presumed. Thus, simply by filing the adversary proceeding seeking the discharge, a debtor would have to establish only that the prior two year's income and the projected current income are below 175% of the poverty level for a family of similar size in order to realize a discharge of the debt.

3. A debtor with a student loan that does not satisfy the presumption of hardship, should be able to establish a Chapter 13 plan which pays as much as possible to all unsecured creditors, including student loans (which would demonstrate the debtor's "best efforts" for a five-year period). Thus, payments would be made on the student loan during the initial five-year period of a Chapter 13 plan fulfilling half of the goal of having student loans repaid within ten years.

4. Approximately six months prior to the completion of payments under a Chapter 13 plan, a debtor should be able to file an adversary proceeding seeking the court's determination as to how much of the remaining student loan debt after the discharge should be paid without imposing a hardship on the debtor. There could be a presumption that a discharged debtor can pay to the student loan creditors what had been paid to unsecured creditors in the soon to be completed Chapter 13 case. Since a debtor would have already experienced four and a half years of a Chapter 13 plan, living under a budget, giving the court an opportunity to see the performance of the debtor, the court can easily determine how much of the student loan is feasible for the debtor to repay for the five years following the discharge of the Chapter 13. The balance of the student loan would be subject to discharge. By effecting a discharge in bankruptcy of a portion of the student loan, the borrower would avoid the taxable consequence of forgiveness of debt.

My proposal has the advantage of:

- (1) avoiding the moral hazard of forgiving debt for individuals who have the capacity to repay their student loans;

- (2) trained professionals would examine the income and expenses of the debtor allowing a judicial determination as to the amount the borrower can afford to pay – first under a Chapter 13 plan – and project such amount after the Chapter 13 plan is completed;

- (3) the plan would be implemented with guidance from a trained Chapter 13 trustee to help insure that, by the end of the Chapter 13 case, the debtor has the experience, the ability, and the capacity to repay the balance of the student loan.

The proposal requires three basic groups to cooperate. First, the DOE would need to presume a hardship. Second, the judiciary – bankruptcy judges – would need to

recognize that a student loan can be partially discharged.⁹ Third, debtors and their counsel would need to file adversary proceedings at the end of the Chapter 13 case seeking a partial discharge of the remaining student loan balance as a hardship.

⁹ The Sixth Circuit has recognized that where hardship is shown, the bankruptcy court may partially discharge a student loan, *In re Miller*, 317 F.3d 616 (6th Cir. 2004); *Bossardet v. ECMC*, 336 B.R. 451 (Bankr. D. Ariz. 2005); *In re Sequeira*, 278 B.R. 861 (Bankr. D. Or. 2001). *In re Mendenhall*, 621 B.R. 472 (Bankr. 2020).