2018

A Complex Analysis of the World of Student Loans

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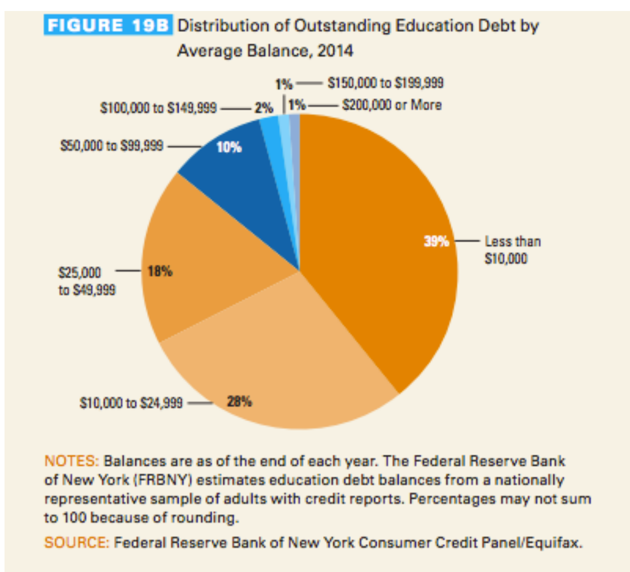
<u>A COMPLEX ANALYSIS OF THE WORLD OF STUDENT LOANS</u>

BY: AIYANA GALLARDO

INTRODUCTION

"Americans today owe more than $1 trillion in student loans either held or guaranteed by the federal government and about $165 billion in private student loans."[1] As of 2015, there are currently 43.3 million student borrowers in the United with a mean balance of loans of approximately $26,700.[2] "Additionally, about 60% of students who earned bachelor's degrees in 2012-13 from public and private nonprofit institutions at which they began their studies graduated with debt."[3] There are two types of student loans, federal and private loans. Depending on the type of loan in which a debtor has, determines what type of repayment options are available to the debtor. In the most extreme of circumstances, a student debtor may even seek bankruptcy in an effort to get their loans discharged. However, this is not as simple as it may seem.

FIGURE 1.1: DISTRIBUTION OF EDUCATION DEBT[4]



[1] Doug Rendleman & Scott Weingart, Collection of Student Loans: A Critical Examination, 20 Wash. & Lee J. Civil Rts. & Soc. Just. 215, 216 (2014), *see also* Rohit Chopra, Student Loan Debt Swells, Federal Loans Now Top a Trillion, Consumer Fin. Protection Bureau (Dec. 18, 2015), http:// www.Consumerfinance.gov/newsroom/student-debt-swells-federal-loans-now-top-a-trillion/; U.S. Dep't of Educ., Federal Student Aid Portfolio Summary, http:// studentaid.ed.gov/sites/default/files/fsawg/datacenter/library/PortfolioSummary.xls.
[2] Federal Reserve Bank of New York, Student Loan Borrowing and Repayment Trends, 2015.
[3] https://secure-media.collegeboard.org/digitalServices/misc/trends/2014-trends-student-aid-report-final.pdf.
[4] Id.

I. TYPES OF BANKRUPTCY

To truly understand bankruptcy, you must first examine the various types of bankruptcies available for a debtor. Personal bankruptcy can be completed under either a Chapter 7 or a Chapter 13 bankruptcy.[5] A Chapter 13 bankruptcy focuses on using future earnings to pay creditors, creating a plan to allow debtors to begin repayment of their debts while also allowing them to gain control of their finances again.[6] The debtor gets to keep their assets, yet must agree to pay a portion of their income to creditors.[7] A Chapter 13 bankruptcy would provide relief from student loans by reducing monthly payments.[8] However, with Chapter 13 bankruptcy, the debtor would still be responsible for the loan balance once the bankruptcy repayment period ends.[9] On the other hand, a Chapter 7 bankruptcy seeks immediate discharge of all their liabilities, with a few exceptions.[10] Here, all student loan debt would be discharged and the debtor, however undue hardship must be proven, would require no repayment.[11]

"The principal purpose of the Bankruptcy Code is to grant a 'fresh start' to the 'honest but unfortunate debtor.'"[12] The Bankruptcy Code allows a debtor to discharge most unpaid debts, if the conditions for discharge are met.[13] However, the Code has various exceptions, which exclude certain debts from being discharged.[14] Section 523 of the Bankruptcy Code

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[5] Elizabeth Warren & Jay Lawrence Westbrook, The Law of Debtors and Creditors 109 (6th ed. 2009).
[6] Id. at 275.
[7] Id.
[8] How to Discharge Student Loans via Bankruptcy, Student Loan Hero (Nov. 2, 2015) http://studentloanhero.com/featured/how-to-discharge-student-loans-via-bankruptcy/.
[9] Id.
[10] Warren & Westbrook, supra at 361.
[11] Id.
[12] Marrama v. Citizens Bank of Massachusetts, 549 U.S. 365, 367 (2007) (quoting Grogan v. Garner, 498 U.S. 279, 286-87 (1991)).
[13] 11 U.S.C. § 523(a).
[14] Id.

provides, that, "[u]nless excepting such debt from discharge . . . would impose an undue hardship on the debtor and the debtor's dependents," discharge is not available for:[15]

> (A)(i) An educational benefit overpayment or loan made, insured, or guaranteed by a governmental unit, or made under any program funded in whole or in part by a governmental unit or nonprofit institution; or
> (ii) an obligation to repay funds received as an educational benefit, scholarship, or stipend; or
> (B) any other educational loan that is a qualified education loan, as defined in section 221(d)(1) of the Internal Revenue Code of 1986, incurred by a debtor who was an individual. [16]

Many have questioned what constitutes a loan under the exceptions of the Bankruptcy Code, Section 523. Courts have addressed the question of what constitutes a "loan" for the purposes of subsections (A)(i) and (B).[17] In In re Renshaw a loan was defined as defined "(i) a contract, whereby (ii) one party transfers a defined quantity of money, goods, or services to another, and (iii) the other party agrees to pay for the sum or items transferred at a later date."[18] Many courts have adopted the Renshaw approach however; many still consider the totality of the circumstances and look to the intent of the parties and what their transaction was intended to accomplish.[19] "Whatever approach a court claims to take, an extension of credit from an institution to a student pursuant to a prior or contemporaneous agreement will usually be found to constitute a "loan" within the meaning of the discharge exception."[20]

Section 523(8)(A)(i) of the Bankruptcy Code excludes all loans granted by the federal government from discharge during bankruptcy. [21] It specifically excludes loans made, insured, or funded by state or local governments; loans funded by nonprofits; and overpayments of

[15] Id.
[16] 11 U.S.C. § 523(a)(8)
[17] In re Renshaw, 222 F.3d 82 (2d Cir. 2000).
[18] Id. at 88.
[19] Rendleman & Weingart, supra, at 276-77; Renshaw 222 F.3d at 82.
[20] Id.
[21] 11 U.S.C. § 523(a)(8).

educational benefits.[22] Additionally subsection (A)(ii) excludes "obligations to repay funds received as an educational benefit, scholarship, or stipend"-which would involve a student who accepted a scholarship or stipend requiring her agreement to perform certain service following graduation, and subsequently failed to perform that service.[23] As per Section 523 of the Bankruptcy Code, "…unless excepting such debt from discharge under this paragraph would impose an undue hardship on the debtor and the debtor's dependents…", educational benefits and loans are not dischargeable.[24] Ultimately this provision prevents all discharges of student loans, unless sufficient undue hardship is present.[25]

Undue hardship truly becomes the central focus of student loan dischargeability. "A debt for a student loan is an exception insofar as it is one of the few types of debt that is conditionally dischargeable in bankruptcy."[26] A debtor merely has to establish that repayment of such a loan would implicate undue hardship.[27] In order to have a student loan discharged under this ideology, the Federal Rules of Bankruptcy Procedure indicate that a debt dischargeability determination must be done under an adversary proceeding.[28] These proceedings loosely resemble federal lawsuits through the filing of a complaint by either a creditor or debtor.[29] The adversary proceedings require a review of the case in order to determine whether the debtor would be under severe undue hardship if required to repay the loan.[30] In a study conducted by Lacey and Pardo, it was discovered that the undue hardship determination outcomes were

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[22] Id.
[23] 11 U.S.C. § 523(a)(8).
[24] Id.
[25] Id.
[26] Pardo, Rafael I., The Undue Hardship Thicket: On Access to Justice, Procedural Noncompliance, and Pollutive Litigation in Bankruptcy, 66 Fla. L. Rev. 2101, 2107 (2014).
[27] Id.
[28] Fed. R. Bankr. P 7001(6)
[29] Pardo, supra at 2107.
[30] Id.

predictable by judge rather than objective measures of financial conditions.[31] Bankruptcy courts are rather inconsistent in their determination of undue hardship and the dischargeability of student loans, forming the basis of most of its criticism.[32]

These adversary proceedings tend to favor creditors through the split structure of the burden of proof.[33] Creditors merely must establish the existence of the education loan debt, whereas the debtor must establish the claim of her hardship.[34]

II. INTRODUCTION TO LOAN TYPES

"In 2013-14, undergraduate students received 54% of their funding in the form of grants, 37% as loans (including nonfederal loans), and 9% in a combination of tax credits or deductions and Federal WorkStudy. For graduate students, these percentages were 32%, 62%, and 6%, respectively." [35]

There are two types of student loans, federal and private loans. Federal student loans are issued in connection to a federal program and are governed by federal law.[36] These loans generally have fixed interest rates, the amount of payment each month can be limited based on income, and there are loan forgiveness options for those who seek careers in public service. However, these loans may not be so easy to attain. With many federal loans, the government will even pay the interest on the loan while the student is in school. Federal student loans are issued under three specific programs: (1) the Federal Direct Loan Program ("Direct Loans"), (2)

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[31] Id. at 2109.
[32] Id.
[33] Id.
[34] Id. at 2110.
[35] Trends in Student Aid 2014, Collegeboard: Trends in Higher Education Series (Oct. 1, 2015), https://secure-media.collegeboard.org/digitalServices/misc/trends/2014-trends-student-aid-report-final.pdf
[36] Rendleman & Weingart, supra, at 218.

the Federal Perkins Loan Program ("Perkins Loans") and (3) the Federal Family Education Loan ("FFEL").[37] The FFEL and Direct loans are further split into Stafford and PLUS Loans.[38]

Stafford loans have more favorable terms, generally have annual and aggregate limits that fail to satisfy the needs of the student borrower and some are even subsidized – meaning they do not accrue interest while a student is in school.[39] Subsidized Stafford loans are merely issued to students who effectively demonstrate financial need.[40] Stafford loans are the most common type comprising between 60 and 80 percent of all student loans.[41]

On the other hand, PLUS loans have higher interest rates and are only available to either the parents of undergraduate students or graduate students.[42]

Perkins loans are available for students that demonstrate financial need, carry a fixed interest rate of five percent and do not accrue interest while the student is in school.[43]

Private loans offer flexible repayment terms but are not funded or subsidized by federal governments. Their sources of loans include, financial institutions, nonprofit organizations, states and some schools.[44] The private lenders set the rates, loan limits and terms.[45] Some variable interest private loans have interest rates, which can rise during the life of the loan, whereas some private loans are fixed rate.

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[37] Id. at 219.
[38] Id.
[39] Id.
[40] Id.
[41] Id.
[42] Id.
[43] 20 U.S.C. § 1087dd(c)(1)(D); 34 C.F.R. § 674.31(b) (1)(i) (2012). *See* Rendleman & Weingart, supra, at 220; 20 U.S.C. § 1087cc(a)(2) (2012) (Monies for Perkins loans are issued from a fund that the school has in their possession. The school examines financial need of their students and distributes funds accordingly; they are limited in scope only serving 1% of the student loan population.).
[44] Id. at 221, *see also* U.S. Dep't of Educ., Your Federal Student Loans: Learn the Basics and Manage Your Debt, Fed. Student Aid at 8-9 (2010), available at https:// studentaid.ed.gov/sites/default/files/your-federal-student-loans_1.pdf.
[45] Id.

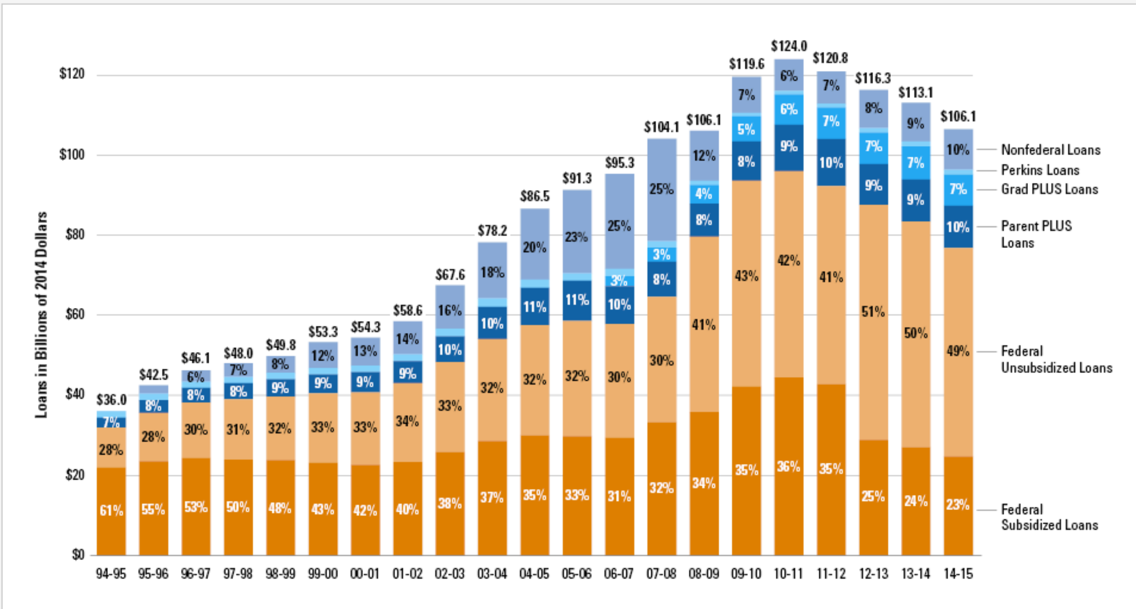
Private loans only account for ten percent of student loans nationwide.[46] This leaves ninety percent of student loans that are funded by the United States Government.[47]

FIGURE 1.2: TOTAL FEDERAL AND NONFEDERAL LOANS OVER TIME[48]

Figure 5: Total Federal and Nonfederal Loans in 2014 Dollars by Type, 1994-95 to 2014-15

Download Data in Excel

See Key Points | See Also Important



Notes & Sources

NOTES: Nonfederal loans include loans to students from states and institutions in addition to private loans issued by banks, credit unions, and Sallie Mae. Values for all types of nonfederal loans are best estimates and are less precise than federal loan amounts.

a. Higher Education

Although, the Government provides support for higher education, it is motivated by selfish intent. It is an investment into the prosperity and development of the United States. On

[46] Total Federal and NonFederal Loans Over Time, Collegeboard (Nov. 1, 2015), http://trends.collegeboard.org/studenaid/figures-tables/total-federal-and-nonfederal-loans-over-time.
[47] Id.
[48] Id.

average college graduates earn 65% more than high school graduates.[49] Higher income means higher tax payments.[50] Higher tax payments means a growing economy in the United States.[51] Not only do college graduates earn more, but individuals with advanced degrees earn two to three times more than high school graduates, meaning higher and higher tax payments.[52]

If only it was so easy, continue your education, make more money and eventually become rich. That is the American dream, isn't it? The reality is that higher education means higher loans. The College Board estimates that the average cost of tuition and fees for the 2014–2015 school year was $31,231 at private colleges, $9,139 for state residents at public colleges, and $22,958 for out-of-state residents attending public universities.[53] The Bureau of Labor Statistics has repeatedly proven that higher education negatively correlates with unemployment rates and positively correlates with wage levels, but this does not negate the amount of loans that are required to attain that level of education necessary to achieve that higher income.[54]

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[49] Sandy Baum, Jennifer Ma & Kathleen Payea, 10, Education Pays 2013: The Benefits of Higher Education for Individuals and Society, Collegeboard, 10, (Nov. 1, 2015), https://trends.collegeboard.org/sites/default/files/education-pays-2013-full-report.pdf.
[50] Id. at 8.
[51] Id.
[52] Education Still Pays, U.S. Bureau of Labor Statistics (Oct. 20, 2015), http://www.bls.gov/careeroutlook/2014/data-on-display/education-still-pays.htm.
[53] What's the Price Tag for College Education?, College Data (Sept. 28, 2015), http://www.collegedata.com/cs/content/content_payarticle_tmpl.jhtml?articleId=10064.
[54] Education Still Pays, supra note 52.

FIGURE 1.3: EDUCATED PERSONS HAVE LOWER UNEMPLOYMENT RATES AND HIGHER WAGES[55]

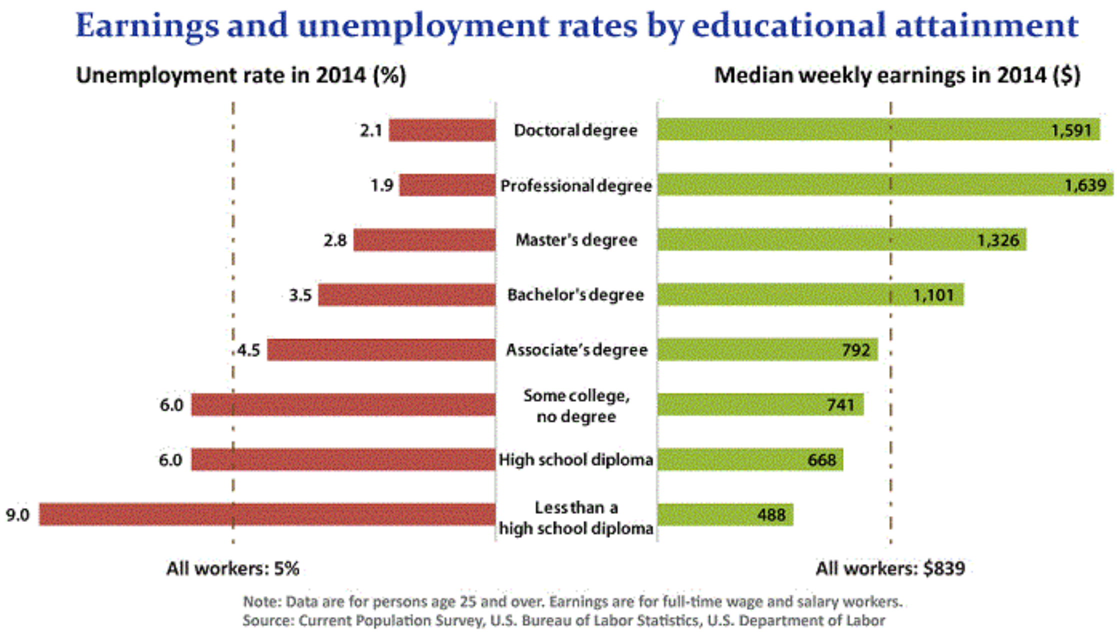
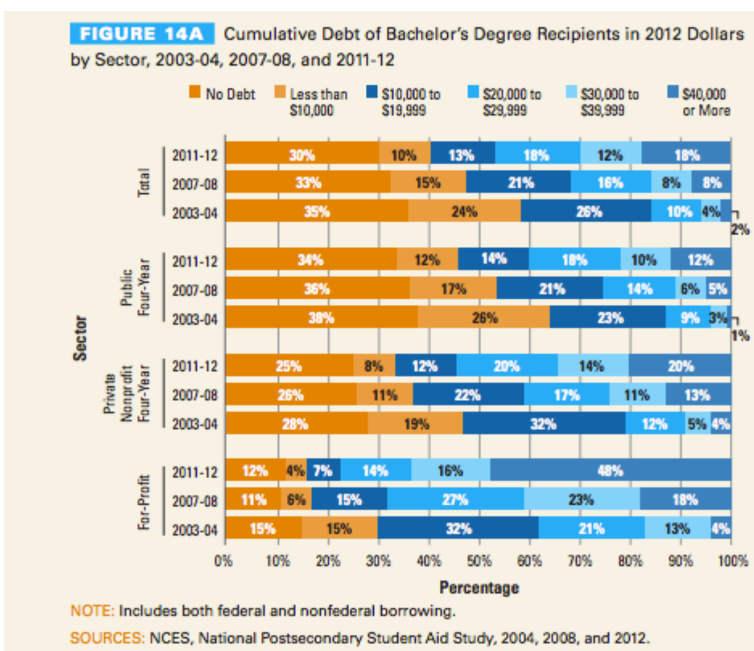


FIGURE 1.4: DEBT OF BACHELOR'S DEGREE RECIPIENTS IN 2012[56]

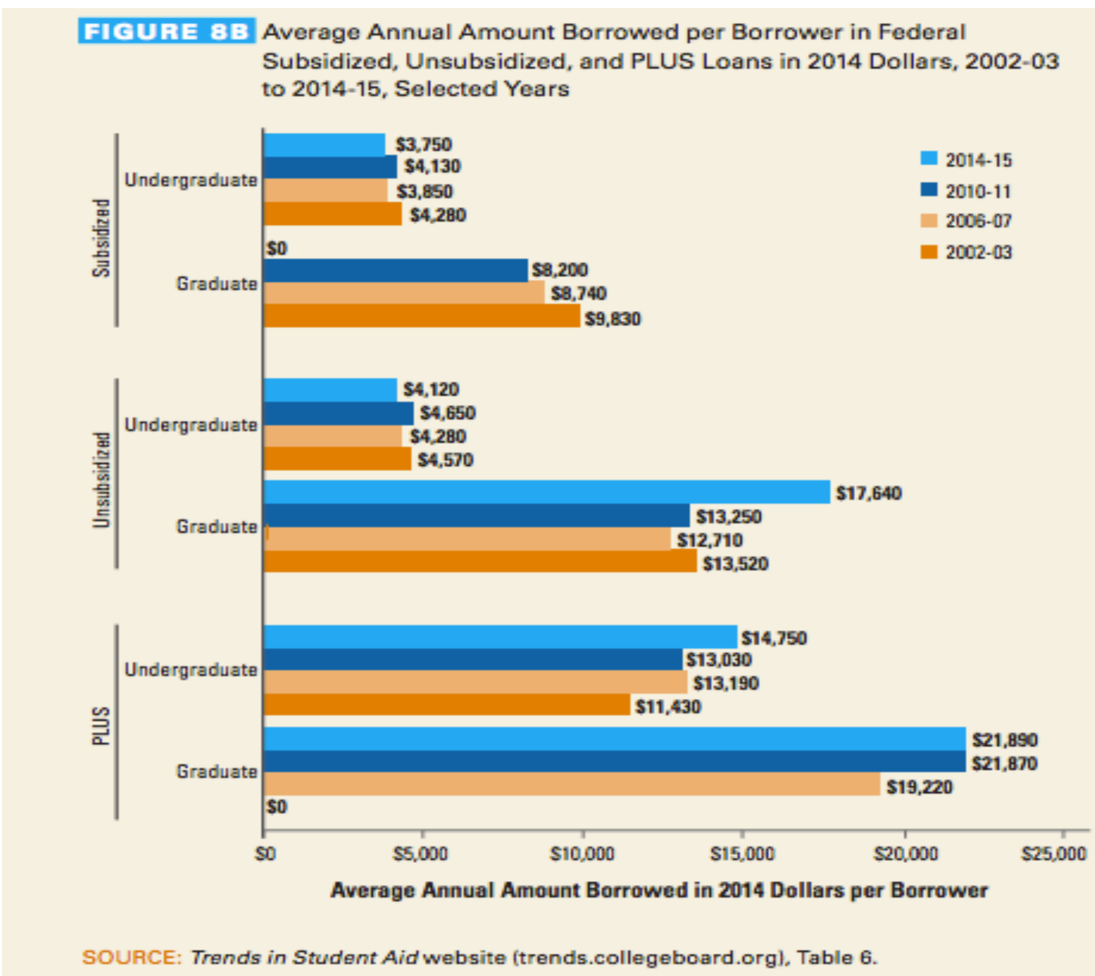


[55] Employment Projections, Bureau of Labor Statistics (Nov. 1, 2015) http://www.bls.gov/emp/ep_chart_001.htm.
[56] Trends in Student Aid 2013, Collegeboard: Trends in Higher Education Series (Oct. 1, 2015), http://trends.collegeboard.org/sites/default/files/student-aid-2013-full-report.pdf.

III. FEDERAL LOANS

Between 2014 and 2015, there were over 6,500 student borrowers for subsidized federal student loans, over 7,700 student borrowers for unsubsidized federal student loans and over 1,000 student borrowers for PLUS federal student loans.[57] As you will see herein, these borrowers frequently take on more than they can handle and must find an alternative to repayment, which in many cases is bankruptcy.

FIGURE 1.5: AVERAGE ANNUAL AMOUNT BORROWED IN FEDERAL LOANS[58]



[57] Trends in Student Aid 2015, Collegeboard: Trends in Higher Education Series (Oct. 1, 2015), http://trends.collegeboard.org/sites/default/files/trends-student-aid-web-final-508-2.pdf.
[58] Id.

a. Avoiding Default

Without the ability to discharge student loans, as discussed above, student debtors turn to the various repayment options available for federal student loans.[59] President Obama enacted the Health Care and Education Reconciliation Act in an effort to assist students in repaying their loans.[60] The new bill caps loan payments to 10 percent of net income and generally forgives them after 20 years of payment.[61] Officially named the William D. Ford Direct Loan program, it hopes to curtail the overwhelming amount of debts that student debtors are liable for repayment.[62] Unfortunately, this program only applies to federal student loans and students with private loans are still left in an unfortunate position.[63] This leaves many debtors with the only viable options being bankruptcy or a voluntary workout with creditors. However, in regards to bankruptcy, without sufficient evidence of undue hardship, is an unlikely solution.[64] Therefore their most likely option becomes a voluntary workout with creditors, which is an agreement between the debtors and creditors.[65] These agreements allow the parties to come to a mutual decision as to the debt and are negotiated without the formalistic procedure of bankruptcy.[66]

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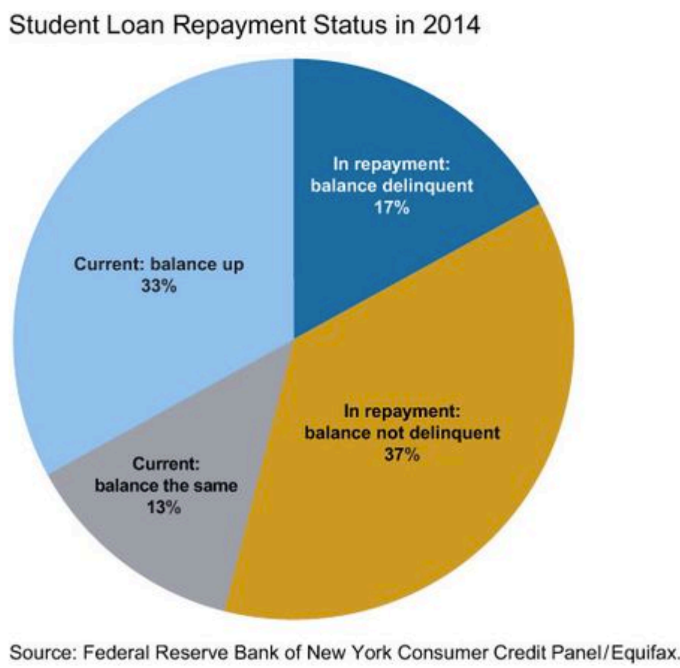
[59] Rendleman & Weingart, supra, at 226.
[60] Summary of the Health Care and Education Reconciliation Act of 2010, Obama Care Facts (Nov. 5, 2015) http://obamacarefacts.com/summary-of-the-health-care-and-education-reconciliation-act-of-2010/.
[61] Health Care and Education Reconciliation Act of 2010, Pub. L. No. 111-152, 124 Stat. 1029 (2010).
; Making College Affordable, The White House (Nov. 5, 2015), https://www.whitehouse.gov/issues/education/higher-education/making-college-affordable.
[62] Health Care and Education Reconciliation Act of 2010, supra note 61.
[63] The Obama Student Loan Forgiveness Program Is A Nickname for the Federal Direct Loan Program, Student Debt Relief (Oct. 20, 2015), http://www.studentdebtrelief.us/forgiveness/obama-student-loan-forgiveness/.
[64] See also *In re Brunner*, 46 B.R. 752, 756 (S.D.N.Y. 1985) (holding that,
"Thus it is proper to require a debtor to show that he or she has made good faith efforts to repay the loan and that the forces preventing repayment are truly beyond his or her reasonable control").
[65] Hon. Conrad B. Duberstein, Out-of-Court Workouts, 1 Am. Bankr. Inst. L. Rev. 347, 347 (1993).
[66] Id.

FIGURE 1.6: SUMMARY OF BORROWERS[67]



i. Deferment

"Deferment: official permission to pay for something at a later time."[68] Depending on the type of student loans and the circumstances of the borrower, the student debtor may be eligible for loan deferment, which means that they can put off repayment of their loans for a period of time. Specifically, borrowers of Stafford Direct loans are given a six month grace period after graduating before they are required to repay their loans.[69] Yet with Direct PLUS loans, repayment begins immediately after graduation, but the borrower can still defer while

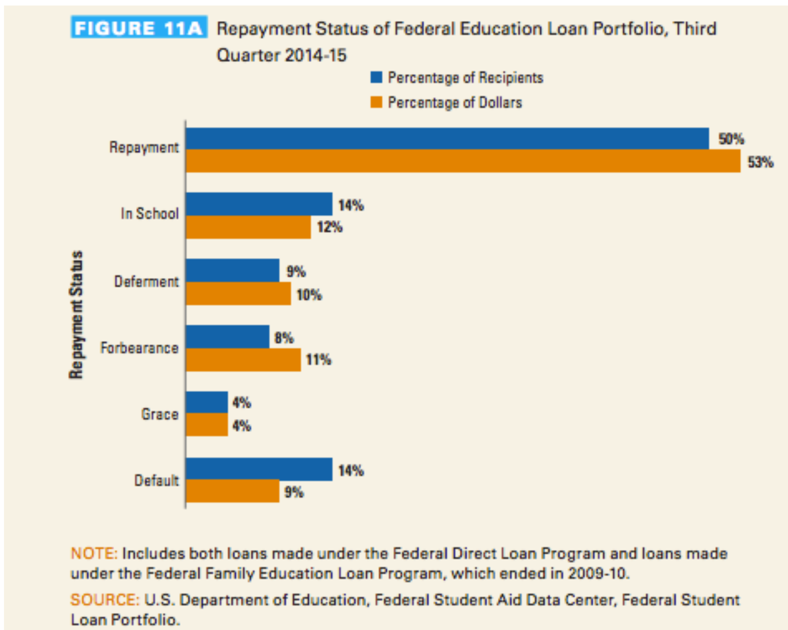
[67] Payback Time? Measuring Progress on Student Debt Repayment, Federal Reserve Bank of New York (Nov. 15, 2015) http://libertystreeteconomics.newyorkfed.org/2015/02/payback_time_measuring_progress_on_student_debt_repayment.html#.Vnh5o5MrKLI.

[68] Deferment | Definition of deferment by Merriam-Webster, Merriam-Webster (Nov. 18, 2015) http://www.merriam-webster.com/dictionary/deferment.

[69] Rendleman & Weingart, supra at 222; *see also* 34 C.F.R. §§ 685.207(b)(1)(ii), (c)(1)(ii) (2009).

attending school.[70] Deferment is a reasonable repayment option for a borrower who is struggling, but has not necessarily reached the point of delinquency with their loans. Reasons for deferment grants include, but are not limited to enrollment in school and economic hardship.[71] In order to properly seek a deferment of one's student loans, the student debtor must make an approved request to the lender.[72]

FIGURE 1.7: REPAYMENT STATUS OF FEDERAL LOANS[73]



ii. Restructuring Repayment

If putting off repayment is not sufficient relief for a student debtor, they may seek out a payment restructuring. There are various repayment plans available to borrowers, who rather than defaulting are looking for a way to restructure their payment plan and in many instances

[70] Id. at 223; *see also* 34 C.F.R. § 685.207(d) (2009).
[71] Id.; *see also* 34 C.F.R. § 685.204(b)(3), (c); 34 C.F.R. § 682.210(s)(6).
[72] Id.
[73] Trends in Student Aid 2015, supra note 57.

lower their monthly payments.[74] Standard, graduated and extended repayment plans are available to all federal student loan borrowers.[75] Whereas, income-based, income-contingent, income-sensitive, and pay-as-you-earn are only available to borrowers based on their income and relative to their debt amount.[76]

Standard repayment plans allow for a fixed monthly payment over a ten-year term and is generally only applicable to Direct and FFEL loans.[77] Graduated repayment plans do not have a fixed payment amount, however the minimum and maximum payment amounts will only differ by a factor of three.[78] Finally, with the extended repayment plan the repayment term is extended, generally to twenty-five years. Yet, the fixed monthly payment is fixed much like the standard plan.[79]

Income-based plans have become more prominent as a repayment option. In 2014, enrollment in income-based repayment plans accounted for over 10.5% of borrowers who were seeking payment restructure. Since 2013, which had a 5.35% enrollment rate, involvement in income-based plans grew 101%, meaning that enrollment grew from 5.25% to 10.5% for income-based repayment plans.[80] The income-sensitive repayment ("ISR") plans are only available for FFEL loans, these plans extend the repayment period by five years, to a fifteen year repayment period, and the borrower must at least, pay the accrued interest each month.[81] The

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[74] Rendleman & Weingart, supra at 226.
[75] Id., *see also* 34 C.F.R. §§ 685.208(b)(1), (c)(1) (2013), 682.209(a)(6)(vi) (2013).
[76] Id., *see also* See 34 C.F.R. § 682.209(a)(6)(viii)(D), (E) (requiring repayment within 15 years).
[77] *See* 34 C.F.R. §§ 685.208(b)(1) Standard and graduated Direct loans have a set period of ten years. *See also* 34 C.F.R. § 685.208(b)(1), (g)(1), (c)(1), (h)(1) (2013). However, the maximum period is longer and dependent on the amount of the loan for borrowers who entered into the repayment option following July 1, 2006.
[78] 34 C.F.R. §§ 685.208(f)(3), (g)(3), (h)(2), 682.209(a)(6)(ii).
[79] 34 C.F.R. §§ 685.208(b)(1), (c)(1) (2013), 682.209(a)(6)(vi) (2013).
[80] Number of Borrowers Using Income-Based Repayment Doubles in One Year, New America EdCentral (Nov. 19, 2015), http://www.edcentral.org/borrowers-using-income-based-repayment-double-one-year/.
[81] Rendleman & Weingart, supra at 227.

ISR does not make the borrower eligible for loan forgiveness, meaning at one point or another the borrower will be required to pay the balance of their loan.[82]

Another option for borrowers with Direct Loans is the Income Contingent Repayment (ICR) plan, where the payments are capped at 20% of the difference between the borrower's adjusted income and the federal poverty guideline.[83]

iii. Income-Based Repayment

One of the most prevalent repayment options is income-based repayment. The College Cost Reduction and Access Act implemented changes to the repayment options of federal student loans.[84] "Except for parent PLUS loans and consolidation loans taken out in part to repay a parent PLUS loan, all Direct and FFEL loans that are not in default are eligible for IBR."[85] This program, Income-Based Repayment Plans or IBR, caps payments at a percentage of the student debtor's income, when a borrower sufficiently proves financial hardship.[86] When proving financial hardship, a borrower must certify her family size to the holder of the loan annually, and, for Direct Loans, she must also consent to disclosure of tax return information by the IRS to the loan holder.[87]

After adjusted payments[88] are made for a significant number of years, usually twenty-five years, the loans are discharged.[89] If a borrower no longer has financial hardship, then payments are re-calculated to the amount that was required prior to entering the income-based repayment

[82] Id., *see also* 34 C.F.R. § 682.209(a)(6)(viii)(D), (E) (payment required within 15 years).
[83] 34 C.F.R. § 685.209(b)(1)(ii)(A)-(B).
[84] Michael Simkovic, Risk-Based Student Loans, 70 Wash. & Lee L. Rev. 527, 617 (2013).
[85] Rendleman & Weingart, supra at 219, *see also* 34 C.F.R. §§ 685.221(a)(2), 682.215(a)(2).
[86] Id.
[87] 34 C.F.R. §§ 685.221(e)(1), 682.215(e)(1); 34 C.F.R. §§ 685.221(e)(2), 682.215(d)(1), (e)(7).
[88] *See* 34 C.F.R. §§ 685.221(b)(1), 682.215(b)(1); 34 C.F.R. §§ 685.221(b)(2)(i), 682.215(b)(1)(i), 34 C.F.R. §§ 685.221(b)(2)(ii)-(iv), 682.215(b)(1)(ii)-(iv) (Monthly payments on eligible loans are limited to one-twelfth of fifteen percent of the difference between the borrower's adjusted gross income and 150% of the poverty guidelines for the borrower's family size. This calculation generally factors out to be about 10% of the debtor's adjusted gross income.
[89] 34 C.F.R. §§ 685.208(d)(1), (e)(1), 682.209(a)(6)(ix), (a)(7)(i).

program.[90] Nonetheless, there is still no real solution for private student loan debtors, who effectively feel that no matter the circumstances they will be entirely unable to repay their loans.[91]

Income based repayment programs: (1) encourage public sector employment and (2) manage downside risks of debt forgiveness. Debts discharged through bankruptcy are not taxable, making this option more appealing for those individuals who may be granted discharge.[92] A New York Times article emphasized that, "When debtors cannot use bankruptcy to modify or discharge debt, lenders are more likely to push loans to excessive levels and create bubbles that can burst with disastrous results."[93]

When a loan is discharged under one of these loan forgiveness programs, the student debtor amount owed monthly is lessened, however their tax liability may increase.[94] There will only be no tax liability if the debtor would be insolvent even after loan forgiveness.[95] When a debtor is not insolvent and loans are discharged, the discharged amount is includable in gross income and therefore taxable.[96] The debtor is held to a higher tax liability due to their loan discharge. Many analysts have suggested that the Income Based Repayment Plan is not as beneficial as it appears on its face; for instance,

> IBR can give you a lower monthly payment right now while your income is low. But your low payment can rise in the future as your income increases. Not only will you be required to pay taxes on the amount discharge, but in addition, if your income increases above "financial

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[90] 34 C.F.R. §§ 685.221(d)(1)(i), 682.215(d)(1)(i).
[91] Matt Sessa, Federal Student Aid Posts Updated Reports to FSA Data Center (Nov. 14, 2015), http://ifap.ed.gov/eannouncements/082015FederalStudentAidPostsUpdatedReportstoFSADataCenter.html.
[92] Topic 431 – Canceled Debt – Is It Taxable or Not?,IRS (Nov. 18, 2015) https://www.irs.gov/taxtopics/tc431.html.
[93] The Editorial Board, Debtors Unfairly Excluded From Protection, The New York Times (Oct. 12, 2015), http://www.nytimes.com/2015/07/16/opinion/debtors-unfairly-excluded-from-protection.html?_r=0.
[94] Jonathan M. Layman, Forgiven But Not Forgotten: Taxation of Forgiven Student Loans Under the Income-Based-Repayment Plan, 39 Cap. U. L. Rev. 131, (2011).
[95] 26 U.S.C. 108(a).
[96] Id.

> hardship" status, and unpaid student loan debt and interest will then be added to your balance, leaving you owing more money. [97]

As described in taxation and discharge herein, Congress has failed to make any amendments to the Internal Revenue Code to prevent the forgiven loan amounts to be excluded from taxable income.[98]

b. Room for Improvement – Risk Based Loans

Income based repayment is a repayment method in which the struggles of student debtors can be alleviated. Federal loan distribution needs to be better regulated, if government were to issue less risky loans there may be less defaults, however this will likely influence the rates of students pursuing higher education. "These federal programs have historically offered loans at rates lower than those offered by most private lenders, on terms that are more attractive to student borrowers, and without adjusting the pricing on loans according to the risks inherent in different courses of study or lending to different types of borrowers."[99] The terms of federal loans offered by the Federal Government make them more attractive to student debtors. The Government is well aware of the difficulties student debtors face when trying to discharge their loans, however they also recognize that they have a high recovery rate on their loans. [100]

One solution, as suggested by Michael Simkovic is risk-based pricing.[101] Currently, "[t]he borrower eligibility criteria for federal student loans are fairly minimal, and generally not risk-based."[102] Rather rate assessments are done through statutory means as opposed to risk.[103]

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[97] Steve Rhode, There's a Catch to Income-Based Repayment That Could Cost You Money, Huffington Post (Oct. 10, 2015), http://www.huffingtonpost.com/steve-rhode/theres-a-catch-to-income_b_6888308.html.
[98] Layman, supra, at 139.
[99] Simkovic, supra at 531.
[100] Id.
[101] Id.
[102] Simkovic, supra, at 561.
[103] Id. at 562.

Rates are fixed at a rate between 4.29% and 6.84% in the current market.[104] Simkovic's solution is to monitor interest rates based on the risk of the borrower; generally the risks should be monitored through their potential employment field.[105] Simkovic believes that a medical student with low risk of default should be issued a loan with a lower rate than an art history major with a high risk of unemployment.[106] "Risk-based credit pricing involves adjusting the interest rate on loans so that the interest rate compensates the lender not only for the time value of money, but also for the risk that borrowers will default on their debts and cause the lender to incur losses."[107] Additionally, he reasoned that, "[r]isk-based student loan pricing should reduce moral hazard by forcing student borrowers to internalize the risks created by their own decisions, encouraging student to study toward high-value occupations."[108] With this model of lending, the government would encourage employment in certain careers, those careers that would regulate the economy and assure repayment of their various loans.[109]

However, one must ask whether risk-based loans could really correct the issue of default. Even if the federal loans become risk-based, this process would likely encourage borrowers to seek out private loans. When high-risk debtors are repeatedly rejected from federal loan programs, their only option to turn to will be private loans. Private loans have higher interest rates, no real repayment options, or loan forgiveness, which will be further developed herein.[110]

As Michael Simkovic developed in his article, Competition and Crisis in Mortgage Securitization:

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[104] Internet Rates for New Direct Loans, Federal Student Aid, An Office of the U.S. Department of Education (Oct. 8, 2015) https://studentaid.ed.gov/sa/about/announcements/interest-rate.
[105] Simkovic, supra, at 566.
[106] Id.
[107] Id. at 589.
[108] Id. at 590.
[109] Id. at 590-91.
110 The Pros and Cons of Private Student Loans, Student Loan (Nov. 19, 2015), http://www.estudentloan.com/blog/pros-cons-private-student-loans.

> Competition can undermine originators' and securitizers' ability to effectively screen loans and securitizers' ability to monitor and discipline originators. Profit driven institutions that do not wish to compete by reducing their revenues and profit margins can instead compete by taking on more risk, ultimately keeping most upside while transferring most downside risk to taxpayers.[111]

Simokovic lends the assumption, that too much competition can actually be harmful, in the sense that lenders would be willing to take on riskier loans in order to stay relevant and in business.[112] This same idea could be easily paralleled to student loan organizations, with too much competition, private loan institutions may be willing to put themselves in a more precarious situation in order to maintain their business flow, while the federal government would turn to a more risk-based analysis before issue a loan. Ultimately this could lead to higher default rates, since student debtors would receive more loans, but at higher rates and in amounts they will be unable to repay.

However, it is likely the positive would outweigh the potential risks. Risk-based student loans can even minimize the gap of wages between different occupations through the incentive of high-demand, high-paying careers.[113] If borrowers realized that they could have lower interest rates on their loans merely based on their educational major choices, they would likely be incentivized to choose a career that would financially benefit them in the long run. Borrowers would be more apt to major in topics, which would place them in more stable, secure and high paying careers.[114] Ultimately these decisions would make them a lower risk lender and cause their loans to have lower payback rates. Not only would these help student borrowers in the long run, but more stable career based students would also create a positive push in the economy. Higher incomes means higher taxes. "Investments in education also generate public returns from

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[111] Michael Simkovic, Competition and Crisis in Mortgage Securitization, 88 IND. L. REV. 213, 268 (2011).
[112] Id.
[113] Simkovic, supra, at 630.
[114] Id.

higher income levels in the form of income taxes, increased social insurance payments and lower social transfers."[115] Not only will the economy benefit from students making more educated career choices, but students will as well considering they will likely be able to pay their loans.[116] Overall, "Risk-based pricing of student loan interest rates would help clarify the links between education choices and employment opportunities."[117]

c. Defaults

If a student fails to properly employ one of the many options used to defer or lower monthly payments, they may find themselves defaulting on their student loans. A FFEL or Direct Loan becomes delinquent the first day after you miss a payment.[118] The lender must make a continued effort to contact the borrower in order to notify them of their delinquency.[119] "At least some of the notices must include information to the borrower about options for avoiding default, including deferment, forbearance, income-sensitive and income-based repayment and loan consolidation."[120] If you repay your loan monthly, default occurs when you fail to make a payment for 270 days, however if you pay your loans less than once a month, default occurs when you fail to make a payment for 330 days, generally this is only applicable to FFEL loans.[121] The consequences of default are strong against the debtor and include: (1) acceleration of payment of the loan; (2) ineligibility for future federal student aid; (3) reports of delinquency to credit bureaus; (4) debt collection through tax offsets, (5) wage garnishment; and (6) possible

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[115] Education at a Glance 2011, OECD 165 (Nov. 20, 2015), http://www.oecd.org/education/skills-beyond-school/48631582.pdf.
[116] Simkovic, supra, at 647.
[117] Id.
[118] Rendleman & Weingart, supra, at 238, *see also* 34 C.F.R. § 682.411(b)(1) (2008).
[119] 34 C.F.R. § 682.411 (2008).
[120] Rendleman & Weingart, supra, at 238, *see also* 34 C.F.R. § 682.411(f) (2008).
[121] Id. at 238-39.

liens against real estate holdings.[122] Once your loans are in default, there are a few option one may employ to get them out, including (1) repayment, (2) consolidation or (3) rehabilitation.[123]

i. Consolidation

"Black's Law Dictionary defines debt consolidation as "[t]he replacement of multiple loans from one or more lenders with a single loan from one lender, usually with a lower monthly payment and a longer repayment period.""[124] A federal student loan borrower may seek out a consolidation loan, if they meet all eligibility requirements and apply to Secretary of Education.[125] Even if the borrower is not in default, they may seek consolidation in an effort to streamline their monthly payments. However, if the borrower is in default they can seek consolidation only by agreeing to repay the consolidation under an ICR, IBR or make three on-time voluntary monthly payments.[126] Consolidation does not only include the principal loan amounts, but also interest and authorized penalties and fees.[127]

> …Consolidation can eliminate certain repayment and cancellation options. For example, a Direct Consolidation loan that pays off a Perkins loan and another kind of loan is not eligible for Perkins loan cancellation. Also, a consolidation loan that pays off a Parent PLUS loan and any other kind of loan is not eligible for income-based or pay-as-you-earn repayment. [128]

Nonetheless even with these considerations, it may still be a very viable and reasonable option for many borrowers. For instance, many FFEL loan borrowers with FFEL may be eligible for an income-based or pay-as-you-earn repayment plan by consolidating the FFEL loans into a

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[122] Don't Ignore Your Student Loan Payments or You'll Risk Going Into Default, Federal Student Aid An Office of the Department of Education (Nov. 18, 2015), https://studentaid.ed.gov/sa/repay-loans/default#what.
[123] Id.
[124] Rendleman & Weingart, supra, at 259, *citing* Black's Law Dictionary (9th ed. 2009), *available* at Westlaw BLACKS.
[125] Id. at 259.
[126] 34 C.F.R. § 685.220(d)(1)
[127] 34 C.F.R. § 685.220(f)(1), (3)
[128] Rendleman & Weingart, supra, at 260-61.

Direct Consolidation loan.[129] All in all, it is quick loan rehabilitation for some debtors in default without the hassle of negotiating a repayment schedule with the creditor.[130]

ii. Rehabilitation

Rehabilitation allows a borrower who is in default on their student loans to get out of default by making timely monthly payments and an upon approval from the Department of Education.[131] Upon discussion and determination of eligibility by US Department of Education's Secretary a written rehabilitation agreement will be provided to the borrower.[132] This agreement will outline the borrower's reasonable and affordable payment amounts, schedule of payments, and also will give the borrower an opportunity to object to the agreement.[133] Loans that have judgments against them are not permitted to be rehabilitated, additionally any loans, that have been rehabilitated once since August 14, 2008 may not be rehabilitated a second time if the borrower subsequently goes into default.[134] Making nine consecutive "voluntary, reasonable and affordable monthly payments within a 20 day period of the due date will also rehabilitate a FFEL or Direct Loan.[135] A "reasonable and affordable monthly payment" is based on the amount owed and the borrower's individual circumstances, including the borrower's income and "reasonable and necessary expenses."[136] Regulations provide that, in order to be rehabilitated, a

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[129] Id. at 261.
[130] Id.
[131] Id., *see also* U.S. Dep't of Educ., PCA Procedures Manual: 2009 ED Collections Contract, Fed. Student Aid 21 (2009), available at http:// epic.org/
foia/ed/EPIC-ED-2009-PCA-Manual.pdf.
[132] 34 C.F.R. § 685.211.
[133] Id.
[134] 34 C.F.R. §§ 685.211(f)(3); 682.405(a)(1); 34 C.F.R. §§ 685.211(f)(4); 682.405(a)(3).
[135] 34 C.F.R. §§ 685.211(f)(1); 682.405(a)(2).
[136] Rendleman & Weingart, supra, at 261; 20 U.S.C. § 1078-6(a)(1)(B) (2010); 34 C.F.R. §§ 685.311(f)(1), 682.405(a)(2); See PCA Procedures Manual, supra note 131, at 103. Depending on whether the loan is a FFEL or Direct loan and the size of the loan, a certain percentage of the balance to be rehabilitated will be considered "reasonable and affordable. Id. at 94, 111-12.

FFEL loan must be sold to an eligible lender, however Direct Loans must only be sold if practicable. [137]

d. Discharge

If a debtor is unable to successfully defer their loans, restructure their repayment plan, or cure a default through consolidation, or rehabilitation, their final option is a discharge. There are two primary methods for discharge for federal student loans, which include: statutory discharges under the Higher Education Act and discharges in bankruptcy.[138]

i. Statutory Discharges

There are two primary statutory discharges: school-related discharges and discharges for death and disability.

School-Related Discharges

School related discharges apply to any student loans obtained after January 1, 1988, when a school closes, has a false certification or has an unpaid refund.[139]

> If the decision-maker is satisfied that the borrower has met the requirements set forth in statute and regulation, the borrower's obligation to repay the loan is discharged. In exchange for discharge, the borrower assigns all claims to a refund for the discharged sum to the Secretary and agrees to cooperate with the Secretary's efforts to enforce these rights. [140]

School closure statutory discharges require that the borrower was unable to complete their educational program as a direct result of the school closing.[141] Whereas, false certification statutory discharges only occur if the student's eligibility for federal student loans "was falsely certified by the eligible institution or was falsely certified as a result of a crime of identity

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[137] 34 C.F.R. § 682.405(a)(2)(ii); 20 U.S.C. § 1078-6(a)(1)(A)(ii).
[138] Terrence L. Michael & Janie M. Phelps, JUDGES?!—WE DON'T NEED NO STINKING JUDGES!!!": THE DISCHARGE OF STUDENT LOANS IN BANKRUPTCY CASES AND THE INCOME CONTINGENT REPAYMENT PLAN, 38 Tex. Tech L. Rev. 73, 79 (2005); 11 U.S.C. § 523(a).
[139] Id.; 20 U.S.C. § 1087(c) (2010).
[140] Rendleman & Weingart, supra, at 262; *see* 34 C.F.R. §§ 685.214(e), 685.215(c)(6)(ii), 685.216(c)(1)(iii)(B), 682.402(d)(5), 682.402(e)(5), 682.402(l)(4)(iii)(B), 674.33(g)(7).
[141] Id. at 263.

theft[.]"[142] A student borrower has to present corroborating evidence, which proves that the school certified an ineligible student as eligible for a loan, the school without authorization signed a loan-related document or the school certified a loan as a result of identify theft.[143] Finally, any student who takes out a FFEL or Direct loan that completes less than 60 percent of the program for which that loan is designated is eligible for a refund from the school.[144] The amount of refund is to be determined by how much of the program the student completed, if the amount of the unpaid refund exceeds the remaining balance of the loan, the student is entitled to be reimbursed for the excess.[145] Under school-related statutory discharges, a student borrower is only eligible if one of the three criteria are met; an unlikely circumstance for the normal debtor.

Death and Disability Related Discharges

Another statutory discharge is the death and disability related discharge. The Department of Education's Secretary, a guaranty agency, or educational institution will discharge a loan upon receipt of a death certificate of the borrower or parent, if a parent PLUS loan.[146] In addition, there is a possibility for discharge if the borrower becomes "totally and permanently disabled."[147] The Education Code, defines "totally and permanently disabled" as:

> The condition of an individual who—
> (1) Is unable to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment that-
>> (i) Can be expected to result in death;
>> (ii) Has lasted for a continuous period of not less than 60 months; or
>> (iii) Can be expected to last for a continuous period of not less than 60 months; or

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[142] 20 U.S.C. § 1087(c)(1).
[143] Rendleman & Weingart, <u>supra</u>, at 262; *see also* 20 U.S.C. § 1087(c)(1).
[144] 34 C.F.R. §§ 685.216; 682.402(l)-(o).
[145] 34 C.F.R. §§ 685.216(d); 682.402(o)(2); 34 C.F.R. §§ 685.216(b); 682.402(l)(3).
[146] 20 U.S.C. §§ 1087(a)(1) (FFEL), 1087dd(c)(1)(F)(i) (Perkins); 34 C.F.R. §§ 685.212(a) (Direct), 682.402(b) (FFEL), 674.61(a) (Perkins). 34 C.F.R. §§ 685.212(a)(2) (Direct), 682.402(b) (FFEL), 674.61(a) (Perkins).
[147] 20 U.S.C. §§ 1087(a)(1) (FFEL), 1087dd(c)(1)(F)(ii) (Perkins); 34 C.F.R. §§ 685.213(b) (Direct), 682.402(c) (FFEL), 674.61(b) (Perkins). "Totally and permanently disabled" is defined at 34 C.F.R. § 682.200.

(2) Has been determined by the Secretary of Veterans Affairs to be unemployable due to a service-connected disability.[148]

In order to properly and effectively seek a discharge due to death or disability an application must be submitted to the lender for FFEL loans or to the Secretary of Education for Direct and Perkins loans alongside a physician certification.[149] Without a physician's certification, the borrower may include their Social Security disability benefit statement.[150] Again, although this statutory discharge is readily available to student borrowers, it is only helpful in limited circumstances. A normal debtor struggling with payments is not necessarily going to satisfy the requirements of either statutory discharge.

ii. Bankruptcy

As previously discussed, under a Chapter 13 bankruptcy, the debtor would still be liable for at least the partial balance of the loan following bankruptcy, depending on the terms of the agreement.[151] This provides relief by lowering the student debtor's monthly payments.[152] A Chapter 7 bankruptcy would seek discharge of the all liabilities.[153] In order to be eligible for discharge, the debtor must prove sufficient undue hardship.[154] The debtor must establish the claim of her hardship in an adequate manner in order to have her debts discharged, a difficult standard to meet.[155]

e. Taxation and Discharge

Well, you got your student loans discharged, now what? In many cases you now have a large tax bill. There are certain loan forgiveness programs, which are considered non-taxable

[148] 34 C.F.R. § 682.200.
[149] 34 C.F.R. §§ 685.213(b)(1), 682.402(c)(2), 674.61(b)(2)(iv); 34 C.F.R. §§ 685.213(b)(2)(i), (b)(3), 682.402(c)(2), 674.61(b)(2)(iv)(A), (b)(2)(v).
[150] 34 C.F.R. §§ 685.213(b)(2)(ii), 674.61(b)(2)(iv)(B).
[151] How to Discharge Student Loans via Bankruptcy, supra note 8.
[152] Id.
[153] Warren & Westbrook, supra at 361.
[154] Id.
[155] Pardo, supra at 2110.

income.[156] These include: public service loan forgiveness, teacher loan forgiveness, law school loan repayment assistance programs and the National Health Service Corps Loan Repayment Program.[157] Nonetheless, they are a number of loan forgiveness programs, which are not excluded from taxable income and ultimately, come with a large tax bill.[158] Section 61(a)(12) of the Internal Revenue Code of 1986 specifies that gross income includes income from the discharge of indebtedness of $600 or more in any calendar year.[159] However, IRC Section 108(f) specifies conditions under which student loan forgiveness is excluded from income. Specifically, IRC section 108(f)(1) states that:

> In the case of an individual, gross income does not include any amount which (but for this subsection) would be includible in gross income by reason of the discharge (in whole or in part) of any student loan if such discharge was pursuant to a provision of such loan under which all or part of the indebtedness of the individual would be discharged if the individual worked for a certain period of time in certain professions for any of a broad class of employers.[160]

Additionally, the code defines a student loan as, including any loan provided to help an individual attend an educational institution.[161] Generally, the code is referring to only federal loans, since the United States or a US agency, a state government or any political subdivision of a state government must have issued these loans.[162] Some education institution issued loans also qualify as student loans provided that the loans came from one of the sources listed above or made under a loan repayment assistance program.[163] All in all, if your loans are forgiven as a result of the income-driven repayment plans, such as Income Based Repayment, the Government

[156] Taxability of Student Loan Forgiveness, FinAid (Nov. 5, 2015), http://www.finaid.org/loans/forgivenesstaxability.phtml.
[157] Id.
[158] I.R.C. § 61(a)(12).
[159] I.R.C. § 108(f).
[160] I.R.C. § 108(f)(1).
[161] I.R.C. § 108(f)(2).
[162] Id.
[163] Id.

will forgive any unpaid balances and not further tax you on this amount, however if merely discharged in bankruptcy there is likely still a tax liability.[164]

IV. PRIVATE LOANS

According to Figure 1.2, nonfederal student loans only account for 10% of all student loans. Even worse than federal loans, student debtors are left at an even bigger disadvantage when they begin to struggle with payments. The various Federal Government funded repayment plans and restructuring plans are not available to private loan borrowers. Their only true form of recourse is bankruptcy, however Section 523 makes it rather difficult to have these loans discharged.

Loan Repayment Assistance Programs ("LRAP") are the only viable solution to assist in payment of private loans other than bankruptcy. Unlike other repayment plans, discussed above, LRAPs provide funds to assist in making monthly payments of private student loans. Private loans, unlike federal loans are not eligible for federal government repayment programs.[165]

> Private loans aren't eligible for federal relief programs such as Income-Based Repayment and Public Service Loan Forgiveness and, as the Consumer Finance Protection Bureau has reported, borrowers often find it very difficult to negotiate an affordable repayment plan. Since you can usually use LRAP funds to pay down your private loans, they are particularly helpful for anyone with a significant amount of private loans.[166]

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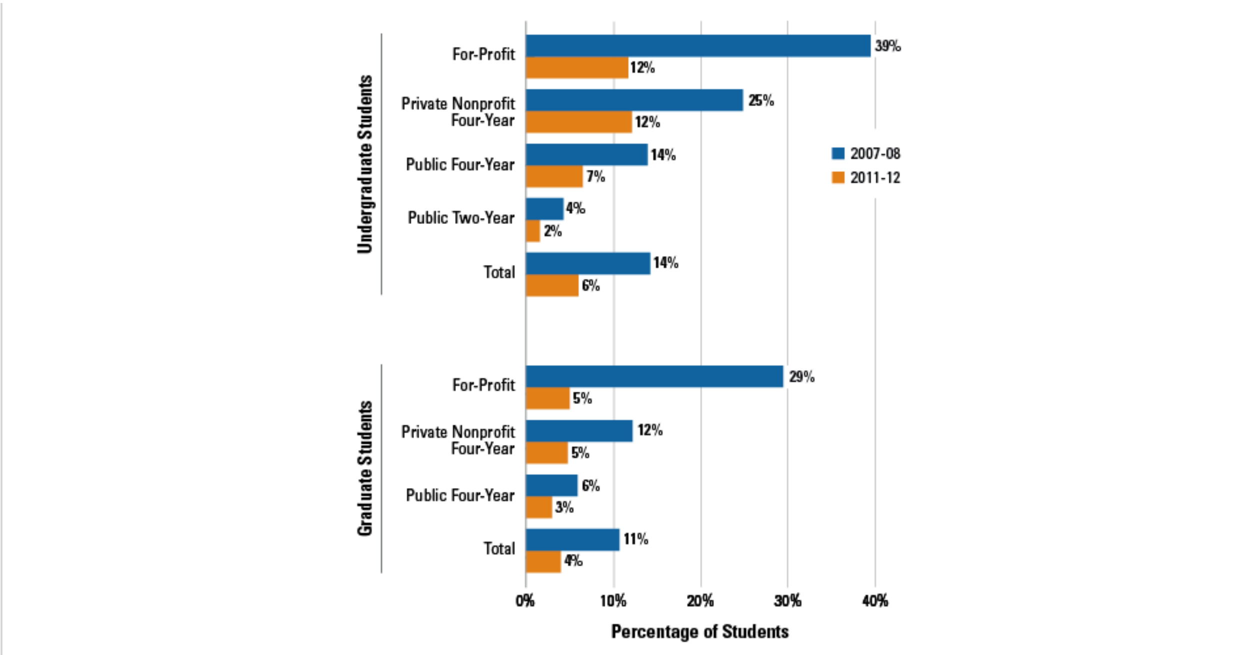
[164] Top Three Tax Issues for Student Loan Debtors, NOLO (Oct. 10, 2015), http://www.nolo.com/legal-encyclopedia/top-three-tax-issues-student-loan-debtors.html.
[165] Evaluate Student Loan Repayment Assistance Programs Before You Apply, U.S. News and World Report (Nov. 20, 2015), http://www.usnews.com/education/blogs/student-loan-ranger/2013/02/27/evaluate-student-loan-repayment-assistance-programs-before-you-apply.
[166] Id.

FIGURE 1.8: PERCENTAGE OF UNDERGRADUATE AND GRADUATE STUDENTS TAKING PRIVATE EDUCATION LOANS, SPLIT BY COLLEGE TYPE 2007-08 and 2011-12[167]



Notes & Sources

SOURCES: NCES, National Postsecondary Student Aid Study 2012; calculations by the authors.

a. Bankruptcy and Private Loans

The Bankruptcy Code's section 523's exceptions further extend to private loans as well in bankruptcy.[168] Specifically, section 523(a)(8)(B) was added in 2005 as part of the Bankruptcy Abuse Prevention and Consumer Protection Act, and exempts "qualified educational loans," as defined by section 221(d)(1) of the Internal Revenue Code, from discharge.[169] A qualified education loan means that the "indebtedness [must be] incurred by the taxpayer solely to pay qualified higher educational expenses."[170] The addition of subsection B to section 532(a)(8) of

[167] Trends in Student Aid 2015, supra note 57.
[168] 11 U.S.C. § 523(a).
[169] 11 U.S.C. § 523(a)(8); I.R.C. § 221(d)(1).
[170] I.R.C. § 221(d)(1).

the Bankruptcy Code was to expand the discharge exceptions to effectively exclude private loans in addition to the already exempted federal student loans.

Nonetheless even with the Section 523 exceptions which provides that private student loans are not dischargeable, there are some instances where they may be discharged. These exceptions include:

- "Mixed-use" private loans, meaning that the loan was taken out for an additional purpose other than education.[171]

- The educational institution has met eligibility requirements for participation in Title IV assistance programs, generally this deals with unaccredited universities or schools.[172]

- The student must have been enrolled in a program leading to a recognized educational credential at an eligible institution of higher education, a course of study necessary for enrollment in such a program, or in a program necessary for a professional teaching credential or certification required by state law for employment as a teacher.[173]

- A loan the borrower incurred to pay another person's educational expenses. This person can neither be a spouse nor a dependent.[174]

However, it is important to note that student loans are not 100% prevented from being discharged in bankruptcy. Private student loans are dischargeable if the debtor can successfully argue that the loans impose an undue hardship, further developed herein.[175]

Even with increasing student loan amounts, the reality of it is that the borrowers who owe the most are the least likely to default on their loans.[176] Many experts in the field seem to believe that higher loans usually correlate with the highest levels of education and therefore the highest

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[171] Rendleman & Weingart, supra, at 274, *see also* 26 C.F.R. § 1.221-1(e)(4).
[172] Rendleman & Weingart, supra, at 274, *see also* 26 U.S.C. § 221(d)(2) ("eligible educational institution" is as defined in 26 U.S.C. § 25A(f)(2)); 26 U.S.C. § 25A(f)(2) ("eligible educational institution" means an institution described in 20 U.S.C. § 1088 as in effect in 1997 and that is eligible to participate in title IV). 20 U.S.C. § 1088 (1997) (amended 1998).
[173] Rendleman & Weingart, supra, at 274, *see also* 26 U.S.C. § 221(d)(3); 26 U.S.C. § 25A(b)(3)(A); 20 U.S.C. § 1091(a)(1)(1997)(amended 1998).
[174] Rendleman & Weingart, supra, at 274, *see also* 26 U.S.C. § 221(d)(1)(A), (d)(4).
[175] Pardo, supra at 2107.
[176] Dynarski, Susan, Why Students With Smallest Debts Have the Larger Problem, The New York Times (Oct. 1, 2015) http://www.nytimes.com/2015/09/01/upshot/why-students-with-smallest-debts-need-the-greatest-help.html?_r=2.

wages.[177] Defaults are prevalent among those who dropout of school without completing their degrees. According to an article by the NY Times, the 3.2 million borrowers who are in default only owe approximately $15,000, where the other 29.4 million individuals owe an average of $26,000. [178]

Although many mistakenly regard all debts as the same for bankruptcy purposes, the reality is that all debts are not created equal. Many critics question how a credit card bill filled with superficial purchases can easily be discharged in bankruptcy proceedings, yet student loans cannot be.[179] It is rather difficult to have student loans discharged as the debtor unless a debtor can meet the undue hardship standard.[180] The fresh start basis of bankruptcy is frustrated through these restrictions, since student debtors are left with their student loan debts following their bankruptcy discharges.[181] Forcing debtors to repay their student loans following bankruptcy proceedings puts debtors into a similar situation as they were preceding the bankruptcy.

However, it could be argued that if discharges are made easier for students, then many would carelessly borrow money for their education, unless lenders began restricting credit or charging higher prices for educational loans. However, the reality is that bankruptcy is a drawn out and complicated legal process with many anti-abuse protections.[182] The likelihood is that many debtors may consider the option of bankruptcy, yet once faced with its realities will not follow through with filing.

As Iuliano explains in his article, <u>An Empirical Assessment of Student Loan Discharges and the Undue Hardship Standard</u>, "Generally one solution to insurmountable debts is to declare

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[177] <u>Id</u>.
[178] <u>Id</u>.
[179] <u>Id</u>.
[180] Pardo, <u>supra</u> at 2107.
[181] <u>Marrama</u>, 549 U.S. at 367.
[182] Bankruptcy Abuse Prevention and Consumer Protection Act of 2005.

bankruptcy".[183] Bankruptcy discharges of student loans require adversary proceedings as opposed to normal bankruptcy proceedings.[184] As opposed to a normal bankruptcy proceeding, debtors have this burden of proving that repayment of their loans would constitute an undue hardship.[185] The problem is, what is undue hardship?

The undue hardship standard requires that debtors establish the following three elements, established by *Brunner v. New York State Higher Education Services Corp.*:[186]

(1) that the debtor cannot maintain, based on current income and expenses, a "minimal" standard of living for herself and her dependents if forced to repay the loans;[187]
(2) that additional circumstances exist indicating that this state of affairs is likely to persist for a significant portion of the repayment period of the student loans; and[188]
(3) that the debtor has made good faith efforts to repay the loans. [189]

The issues surrounding the undue hardship test is that Congress failed to sufficiently define undue hardship.[190] Much of the undue hardship interpretation is left to judicial review.[191] Additionally as *Brunner* emphasizes, statutory history is the only real foundation for interpretation. [192]

> The Commission envisioned a determination of whether the amount and reliability of income and other wealth which the debtor could reasonably be expected to receive in the future could maintain the debtor and his or her dependents at a minimal standard of living as well as pay off the student loans.[193]

It is important to note that the Commission on the Bankruptcy Laws of the United States included the "undue hardship" requirement in an effort to quash bankruptcies for the primary

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[183] Iuliano, Jason, An Empirical Assessment of Student Loan Discharges and the Undue Hardship Standard, 86 AM. BANKR. L.J. 495, 496 (2012).
[184] Id.
[185] Id.
[186] Brunner v. New York State Higher Education Services Corp., 831 F.2d 395, 396 (2d Cir. 1987).
[187] Id.
[188] Id.
[189] Id.
[190] Iuliano, supra at 496.
[191] Id.
[192] In re Brunner, 46 B.R. 752, 756, 753 (S.D.N.Y. 1985)
[193] Id. at 754, citing 124 Cong.Rec.H. 11096, 95th Cong., 2d Sess. (daily ed. Sept. 28, 1978).

reason of discharging student loans. [194] It is insufficient to show that current finances and loan repayments will be difficult or impossible, more is required by the court system – specifically those requirements stated above.[195]

Not only must the factors of undue hardship be weighted against student's loans, but they must be considered individually for each loan.[196] In In re Andreson, it was determined that a court must look to each individual loan in order to determine whether it is dischargeable.[197] As the court reasoned, "Many of the cases on both sides of the issues [whether student loans are partially dischargeable] completely overlook the apparently express wording of the statute which mandates an undue hardship evaluation for each individual student loan obligation."[198] Undue hardship is not a collective issue surrounding all student loans.[199] It is very possible that one loan could be discharged, while three others must be repaid.

As we examine the undue hardship standard, we find that many heavily criticize the undue hardship standard because of its unfair application. According to Iuliano, many scholars argue that the undue hardship test is too burdensome and unfairly and unequally applied.[200] Iuliano researched and compared non-discharge seekers to discharge seekers and found that, "…tens of thousands of non-discharge seekers are as bad off financially as the typical discharge seeker. This suggests that many more debtors could obtain relief if they filed an adversary proceeding to request a discharge" yet many believe they will not satisfy the undue hardship requirements.[201] He also emphasizes various reasons as to why these percentages might be so

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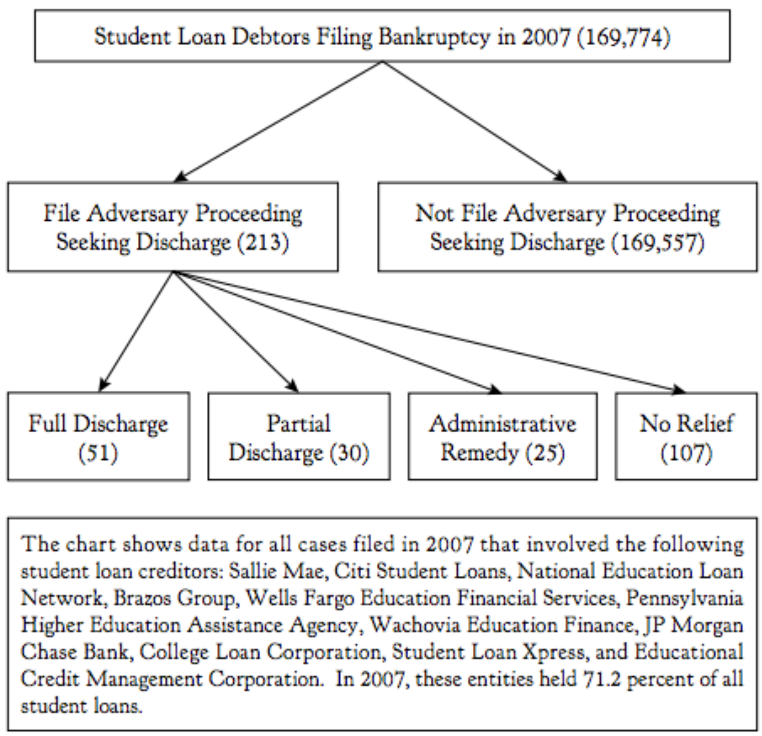
[194] Id. at 754.
[195] Id. at 755.
[196] In re Andresen, 232 B.R. 127, 128 (8th Cir. 1999)
[197] Id.
[198] Id. at 134.
[199] Id.
[200] Iuliano, supra at 498.
[201] Id. at 500.

low, including lenders discharging loans outside of bankruptcy, administrative remedies or fear of denial in discharges of student loans.[202]

FIGURE 1.9: THE PATH TO BANKRUPTCY[203]

Figure 1: The Path of Student Loan Debtors in Bankruptcy



No matter what the reason for non-discharge seekers, the reality is that they are generally not anymore financially prepared to handle their loan than discharge seekers. It was discovered that non-discharge seekers generally "…make less money, own fewer assets, and have more liabilities, including educational debt" than discharge seekers.[204] Out of those who sought discharge only 39% received some form of relief.[205] Many critics find that these precise numbers

[202] See generally, Id. at 506. ((1) Lenders are granting discharges outside of bankruptcies; (2) administrative remedies; (3) or debtors do not feel that there loans will actually be discharged).
[203] Id. at 505.
[204] Id. at 511.
[205] Id. at 512.

are the reason that the undue hardship test is an insufficient alternative to altogether forbidding student loan discharges.[206] According to Iuliano, "Only three variable remained statistically significant across a wide variety of models.[207] There were (1) whether the debtor has a medical hardship, (2) whether the debtor is employed, and (3) the debtor's income the year before filing bankruptcy."[208] Should these really be the only factors that are considered for undue hardship? Or should we be more forgiving of other factors, which may affect a debtor's ability to repay their loans?

FIGURE 1.10: DISCHARGE FREQUENCIES[209]

Figure 6: Discharge Frequencies, by Regression Variables

Groups	Observations	No Discharge	Partial Discharge	Full Discharge
Medical Hardship	104	48%	17%	35%
No Medical Hardship	98	73%	11%	15%
Employed	120	68%	16%	16%
Unemployed	81	48%	12%	40%
Attorney	163	61%	13%	25%
Pro Se	42	57%	19%	24%
Prior Year Income	197	$28,272	$20,072	$16,394

Iuliano's perspective is evidence that individuals are uninformed regarding student loan discharges.[210] However, even if the debtors were properly informed, discharges are still granted in a discriminatory manner.

Nonetheless, what many fail to distinguish is the differences between federal and private loans. Although federal loans are not dischargeable, they can be mitigated through IBR.[211] Yes,

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206 Id.
207 Id. at 518.
208 Id. at 518.
209 Id.
210 Id. at 512.
211 Rendleman & Weingart, supra at 219; *see also* 34 C.F.R. §§ 685.221(a)(2), 682.215(a)(2).

they are technically still paying back their loans, but the payments will be artfully adjusted to represent the borrower's abilities based on their current and future income. Many feel that this is not a reasonable alternative, yet the reality is that this is a very worthwhile solution. The government gets repaid, albeit less than they originally intended but paid nonetheless.[212] Furthermore the student borrowers also benefit because they are able to have their payments adjusted to better ameliorate their current circumstances. These federal repayment options are entirely unavailable to private student loan, leaving a private loan student debtor in a precarious situation.[213]

b. Discharge and Taxation

According to the IRS, a debt "includes any indebtedness whether you are personally liable or liable only to the extent of the property securing the debt".[214] A debt that is canceled, forgiven or discharged will generally require the filing of a Form 1099-C with the IRS.[215] This form will require the debtor to include the canceled amount in gross income unless some exception is met.[216]

As per the rules of the Form 1099-C, when the cancelled debt totals more than $600, the lender must report such cancelled debt on a 1099-C form.[217] However, it is important to note that not all cancelled student loan debt is taxable. The IRS states that in order to qualify for exclusion from gross income the student loan must have been made by: (1) The Federal Government, a state or local government or subdivision of one of those government; (2) a tax-

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[212] Id.
[213] Evaluate Student Loan Repayment Assistance Programs Before You Apply, supra note 165.
[214] Topic 431 – Canceled Debt – Is It Taxable or Not?, Internal Revenue Service (Nov. 19, 2015) https://www.irs.gov/taxtopics/tc431.html.
[215] Id.
[216] Id.
[217] Id.

exempt public benefit corporation; or (3) an education institution.[218] Since we have learned that private loans are issued by profit earning institutions, they are not included in the Form 1099-C exception and therefore are taxable income even if they are discharged in bankruptcy.[219]

V. POLICIES FOR IMPROVEMENT

It would appear that one of the biggest issues surrounding student loans and bankruptcy is accountability. The student debtors do not understand the long-term repercussions of borrowing such large and overwhelming amounts of money. Even the lenders have no accountability since they are almost always guaranteed payment. Finally, the universities and colleges do not have any accountability because in no way are they ever held liable for unpaid debts.

Proposal I: It is possible that by holding universities and colleges accountable for the debts, there might be some positive effects for bankruptcy filings. The schools could no longer turn a blind eye to the insurmountable amounts of debts that their students are taking out in order to attend their schools. If the schools were in fact held accountable, when a student defaulted they would be responsible, even partially, for paying back the lenders. On the other hand of this idea, we must consider the fact that students may begin to lose access to student loans. Universities might be fearful and therefore unwilling to provide loans to their student based on the idea that they could be held liable. Not to mention that if in the current lending situation student loans have high default rates, what's going to happen when a plan like this is implemented? Universities will quickly realize the risk of lending to their student borrowers and if held liable they will be less likely to lend the money. Universities may also begin charging higher tuition in order to compensate for any money lost through loan discharges. Where will student borrowers be able to get loans or compensate for the higher tuition?

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[218] Id.
[219] Id.

This proposal may also be difficult because universities do not have access to credit reports or the general credit worthiness of student debtors. This would be especially true relating to smaller universities and colleges. It is also relevant to consider that lenders are trained to analyze credit worthiness. It is unlikely that the employees at the universities would be willing and qualified to handle loan distribution.

Finally, although a reasonable proposal, this likely would raise university costs. The universities would need additional resources and training to properly distribute all student loans. Holding universities liable in theory is a practical solution, once the technicalities of the plan are considered, it seems unlikely that this would solve the rising default rates of student loans.

Proposal II: Risk-based student loans would ensure that a reasonable investment was being taken into the student. An assessment would involve a review of their future careers, their income prospect, and possibly even their creditor scores and reports. By doing this, lenders would be able to make an accurate determination as to how likely the borrower would be to default. Riskier borrowers would have higher rates, whereas safer borrowers could have lower rates. The lender would adjust interest rates based on the riskiness of the borrower. Likely this would result in an analysis of the future employment prospects and credit scores. "Risk-based credit pricing involves adjusting the interest rate on loans so that the interest rate compensates the lender not only for the time value of money, but also for the risk that borrowers will default on their debts and cause the lender to incur losses."[220]

The issues concerning risk-based student lending is that when a student is denied from a federal loan due to their riskiness, they will seek out private loans. As seen above, private loans do not have the flexible repayment options offered by the federal student loans. The only viable

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[220] Simkovic, supra, at 589.

option for a private loan borrower is that of discharge. Unfortunately with the ever-changing undue hardship standard, it can be rather difficult to have a private student loan discharged. Therefore it seems unlikely that this proposal would be entirely effective.

Proposal III: Based on Iuliano's study, we must find a way to regulate the undue hardship standard. In a manner in which there is no discrimination. There should be a judicial standard for discharge as opposed to a judicial interpretation and determination. As explained above, in a study conducted by Lacey and Pardo, it was discovered that the undue hardship determination was merely a judicially interpreted concept; there is no real guidelines or procedure for determination.[221] Therefore there is no real standard to determine whether a debtor is facing undue hardship, but rather each individual judge is given the freedom to interpret the situation on his or her own. If a standardized process were implemented, judges would be able to more effectively determine whether a student loan would need to be discharged. This likely would allow for a more streamlined process when it came to student loans and bankruptcy discharges.

Proposal IV: The rate of default is being kept to a minimum at a current 17%.[222] Therefore it seems feasible that rather than finding a solution to prevent default, it is more feasible to educate the lender. By requiring an educational course before taking out student loans, borrowers will be fully informed in regards to their repayment options. Borrowers will be informed about their options in regards to student loans both within and outside of bankruptcy. They will learn about repayment options, including: deferment, restructuring repayment, income-based repayment plans, statutory discharges and bankruptcy. In addition, they will be properly educated about the differences between Chapter 7 and Chapter 13 bankruptcies and the long-term repercussions of both.

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[221] Pardo, supra at 2109.

[222] Payback Time? Measuring Progress on Student Debt Repayment, supra note 67.

VI. CONCLUSION

Through this complex analysis of student loans, we learned that all loans are certainly not created equal. Federal and private loans certainly differ in most respects, including the process to obtain such loans, the ability to restructure such loans and finally the standard to discharge such loans. Although various proposals were introduced in an effort to curb the concerns regarding defaults and student loans and bankruptcy rates it seems unlikely that one simple solution would be feasible for all. "Americans today owe more than $1 trillion in student loans either held or guaranteed by the federal government and about $165 billion in private student loans."[223]

The reality is that only 17% of debtors are defaulting on their loans.[224] Although this is significant, in the larger scheme of this, there are 83% of debtors who are able to pay their loans. It is important to continue to evaluate defaults and find a solution, which keeps them to a minimum. However it seems impossible that student loan discharges will ever reach 0% of the population. There will always be a debtor who is unable to make their payments, yet an optimal level seems to be approximately 15% of the population.

It is difficult to propose a solution, which would satisfy the hardships surrounding student loans. Therefore, the most feasible solution seems to educate debtors about their options. There is no way to curtail all defaults surrounding loans. Initially it seemed apparent that conservative lending would solve the problem of discharges, yet as discussed this would not be a simple solution either. Rather by educating student borrowers about their options, they will be well informed and prepared to face the challenges of student loan repayment. Loan education will allow lenders to know what they are getting themselves into before getting into large debts.

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[223] Rendleman & Weingart, supra at 216.
[224] Payback Time? Measuring Progress on Student Debt Repayment, supra note 67.