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**RE: Docket ID ED-2017-OPE-0085, Request for Information on Evaluating Undue Hardship Claims in Adversary Actions Seeking Student Loan Discharge in Bankruptcy Proceedings**

The NYC Department of Consumer Affairs ("DCA") appreciates the opportunity to comment on the U.S. Department of Education's ("DOE") Request for Information, which seeks to establish consistent guidelines for loan servicers to follow in their decision to dispute or concede to undue hardship claims. DCA believes redefining these servicer guidelines is an important step in the process of addressing the ongoing student loan crisis in the United States.

DCA's mission is to protect and enhance the daily economic lives of New Yorkers to create thriving communities. DCA licenses more than 81,000 businesses in more than 50 industries and enforces key consumer protection, licensing, and workplace laws that apply to countless more. By supporting businesses through equitable enforcement and access to resources, and by helping to resolve complaints, DCA protects the marketplace from predatory practices and strives to create a culture of compliance.

DCA envisions a city where all New Yorkers and communities are empowered to make financial decisions that promote their long-term financial stability and financial health regardless of their income or the income of their residents. Within DCA, the Office of Financial Empowerment ("OFE") works to realize this vision by educating, empowering, and protecting New Yorkers and neighborhoods with low incomes so that they can build assets and make the most of their financial resources. Using a range of tools, including data and research, community engagement, convening, and partnerships, we develop, offer, and advocate for innovative programs, products, and policies that support the financial health of all New Yorkers.

In December 2017, DCA and the Federal Reserve Bank of New York released a report, *Student Loan Borrowing Across NYC Neighborhoods*, the first neighborhood-level examination of student loan outcomes. Our joint report detailed the extensive student loan debt in our city and the inability of many New Yorkers to repay that debt. At the end of 2016, approximately 15 percent of New York City adults had a student loan, with a median balance of $16,957, or 32% of median income.[1] Of the nearly one million New York City borrowers, about 16 percent of student loan holders have defaulted (defined as being 270 or more days overdue on student loan repayments). The share of residents struggling with student debt rises even further when one narrows the focus to low-income zip

[1] https://www.newyorkfed.org/medialibrary/media/outreach-and-education/community-development/credit-conditions/student-loan-borrowing-nyc-neighborhoods.pdf

codes, as nearly a quarter of residents with a student loan in the lowest-income areas have defaulted.[2] There are also very high concentrations of defaulted borrowers across neighborhoods in the Bronx and Brooklyn where loan balances are below $5,000. One in six borrowers in these neighborhoods has defaulted on student loans, despite small average loan balances.[3] Problematic student loan debt in New York City has, and will continue to have, a dampening effect on home ownership, career flexibility, and general household financial health. And for the New Yorkers with lower incomes we highlight in our report, the student debt crisis is even more severe and damaging to financial health. It is this on-the-ground perspective that informs these comments and recommendations for meaningful reforms DOE could implement to address this crisis.

At the heart of U.S. bankruptcy law is the idea that sometimes life does not go as planned, so people deserve a fresh financial start.[4] Over the years, Congress has eroded the notion of a 'fresh start,' especially when it comes to student loan debt. As of 1998, student loans were no longer dischargeable forms of debt, though lawmakers did add an exception for cases of 'undue hardship.' What was meant by 'undue hardship' was never defined in law and the authority to define the term was never granted to the DOE; thus the default arbiter of what this term means is the judge presiding over each bankruptcy hearing.

While case law does guide judges in their determinations, this guidance has been inconsistently applied. The majority of federal circuits apply the '*Brunner* test,' a strict legal standard established in the 1987 Second Circuit case *Brunner v. New York State Higher Education Services Corp.* The other test, 'totality of circumstances test,' a slightly more flexible standard that allows the judge to consider all of the circumstances faced by the borrower, has been adopted by the Eighth Circuit. The First Circuit is divided between the two tests. The disparate interpretation of the 'undue hardship' requirement creates two different and subjective standards for determining undue hardship and essentially relegates borrowers to the status of victims of geography.

Further, the case law surrounding undue hardship was established under a more lenient legal framework. When the *Brunner* test was established, undue hardship had to be proven only if the loan was within five years from the start of the repayment period. After this period, loans were fully dischargeable in bankruptcy. Also at this time, private student loans were yet to be determined non-dischargeable. Bankruptcy laws were also much more lenient before the 2005 Bankruptcy Abuse Prevention and Consumer Protection Act, which added a means test for eligibility for Chapter 7 debt relief, among other restrictive changes.

The entire landscape of student borrowing and higher education has been transformed in the 30 years since *Brunner*, as well. Tuition has skyrocketed. In this time, annual tuition for a private nonprofit university increased 129 percent and for a public university tuition increased a staggering 213 percent, adjusted for inflation.[5] Loan balances have ballooned; with the average cumulative balance held by borrowing seniors in 2011-2012 increasing an inflation-adjusted 73 percent from the cohort 12 years

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[2] ibid

[3] ibid

[4] http://www.uscourts.gov/services-forms/bankruptcy/bankruptcy-basics/process-bankruptcy-basics

[5] https://trends.collegeboard.org/sites/default/files/2017-trends-in-college-pricing_0.pdf

earlier.[6] Wages have been fairly stagnant since the 1970's,[7] which suggests the student loan debt-to-income ratio is ratcheting up. For borrowers who first entered college in 2003-2004, the cumulative default rate after twelve years was 27 percent, about 9 percentage points higher than the twelve-year cumulative default rate for borrowers entering college in 1995-1996.[8] These disturbing trends are happening in tandem with serious labor market shifts. An estimated 65 percent of jobs will require education and training beyond high school by 2020, compared to 56 percent in 1992 and 28 percent in 1973.[9]

These trends - increasing tuition and borrowing, stagnant wages, more defaults, and higher demand for high-skilled workers - all point to an impending problem that current administrative and judicial procedures for student loan borrowers are ill-equipped to handle. Altering the guiding principles for disputing or conceding an undue hardship claim will do very little to address the colossal problem that has arisen in the absence of leadership on the student loan debt crisis. For these reasons, we propose the following eight recommendations for addressing this critical policy issue:

**1 – We strongly urge Congress to revert to the previous 5-year non-dischargeability period**, a move that has garnered some support from the student loan industry.[10]
Borrowers who pursue higher education do so with the intention of increasing their earnings over time. Sometimes, their expectations are not met and they fall into repayment difficulties, just as with consumer debt. While some of the legislative changes to student loan dischargeability were made during a time of increasing defaults, the limited available research does not support the justification for non-dischargeability, namely that the non-dischargeability of student loans protects against a crisis of default and bankruptcy.[11]

**2 - If undue hardship is maintained as a requirement for dischargeability, we suggest Congress eliminate the adversary proceeding.** The adversary proceeding requires a consumer debtor who has already filed a bankruptcy petition to initiate an additional lawsuit in bankruptcy court. The adversary proceeding is burdensome and costly for most consumer debtors, who typically need to hire an attorney to represent them in the proceeding to respond to discovery demands and participate in what can be extensive motion practice. Additionally, the consumer debtor may be subjected to the aggressive tactics of lenders who are financially incentivized to ensure that the student loan discharge process is not an easy one. Some anecdotal evidence shows that this has a dampening effect on legitimate claims for loan discharge, a concern alluded

[6] https://nces.ed.gov/pubs2017/2017436.pdf
[7] http://www.hamiltonproject.org/assets/files/thirteen_facts_wage_growth.pdf
[8] https://nces.ed.gov/pubs2018/2018410.pdf
[9] https://cew.georgetown.edu/wp-content/uploads/2014/11/Recovery2020.ES_.Web_.pdf
[10] Sallie Mae - https://scholarship.law.upenn.edu/jbl/vol14/iss4/8/ and Navient - https://www.marketwatch.com/story/class-action-lawsuit-against-student-loan-giant-brings-hope-to-borrowers-in-bankruptcy-2018-04-09
[11] Dorolia and Ritter (2017) found no meaningful changes in bankruptcy filings after student loan nondischargeability was expanded to include private loans https://www.philadelphiafed.org/-/media/research-and-data/publications/working-papers/2017/wp17-38.pdf?la=en, and Yannelis (2017) showed that the removal of bankruptcy protection after 7 years in repayment would only increase the default rate by 0.25 percentage points http://faculty.chicagobooth.edu/workshops/financelunch/past/pdf/Strategic%20Default.pdf

to in the Department's Request for Information.[12] As it stands, bankruptcy trustees and judges are already tasked with determining the merit of a bankruptcy case and are equally capable of determining undue hardship without this additional proceeding. Furthermore, the number of people filing for this type of debt relief is low when considering how many people are in default and struggling to keep up with their student loan payments.

**3- If the undue hardship standard is maintained, Congress should clearly outline the procedure for establishing undue hardship to ensure the equal and consistent application of the law.** As discussed above, and as listed as one of the very reasons for this Request for Information, the circuit courts are interpreting the undue hardship standard differently. Congress should give clarifying guidance in favor of the more lenient standard.

**4 - Congress should move to end the non-dischargeability of private student loans.** Protecting private lenders in this manner without establishing standards of conduct creates a moral hazard for lenders, allowing them to engage in potentially irresponsible lending without the repercussion of absorbing losses from bankruptcy to serve as a deterrent. While this protection was provided under the assumption that it would lead to expanded credit access for student loan seekers, there is some indication that it has not accomplished this goal.[13]

**5 - Congress should clarify and narrow what counts as an educational benefit.** The current vague language surrounding non-dischargeability has led to an overly broad interpretation wherein loans for programs and services at unaccredited institutions, for tutoring, and for funds that surpass the cost of college are deemed ineligible for bankruptcy discharge.[14] Only loans directly related to the higher education or job training should benefit from non-dischargeability.

**6 - Congress should ensure that loan forgiveness is not counted as taxable income for low-income households.** The current system has the potential to cause severe disruptions in means-tested benefits eligibility, as well as for creating an unmanageable tax burden for households who already have an established inability to service their debt.

**7 - Congress should change the procedure around administrative garnishments to match repayment calculations used for Income-Driven Repayment (IDR).** Differences in calculating disposable income create a standard whereby IDR participants are allowed a higher standard of living than borrowers in garnishment. In other words wage garnishment is essentially an auto-enrollment into an income based repayment plan but at much worse terms. In addition, garnishments allow for a higher percentage of wages above disposable income to be collected than is the case for IDR repayments, 15 percent versus 10 percent. These inconsistencies create an unnecessarily punitive system for struggling borrowers.

**8- The DOE should eliminate the role of private Debt Collection Agencies in the federal student loan system and decrease the fees assessed when a loan goes into default.** The

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[12] https://www.nytimes.com/2012/09/01/business/shedding-student-loans-in-bankruptcy-is-an-uphill-battle.html?_r=1&pagewanted=all

[13] http://www.finaid.org/educators/20070814pslFICOdistribution.pdf

[14] https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3139985

lender has a longer relationship with the borrower and should be better incentivized to guide borrowers into the most appropriate repayment plan. In addition, adding excessive fees to defaulted loans further compromises struggling borrowers' ability to repay their loans.

We strongly urge the DOE take the above strategies into consideration and provide feedback to Congress accordingly.

Regarding adversary proceedings, we recommend that the DOE advise lenders to discontinue the process of contesting claims of undue hardship. The current guidance for disputes creates perverse incentives for companies contracted to handle cases in adversary proceedings because they earn money from fees charged to and commission earned on debt collected from student loans in default. This all adds an extra burden on distressed borrowers. In order to prove undue hardship, the borrower must prove his or her inability to earn enough money to repay his or her debts now and into the future, a standard that goes beyond the eligibility requirements for Chapter 7 bankruptcies.

It would be of greater benefit to student loan borrowers if the DOE exerted more effort to hold loan servicers accountable for consistently and clearly informing borrowers of their repayment options to ensure that all borrowers receive the same information about available repayment plans. Income-driven repayment (IDR), though not always the right option for every borrower, is an underutilized tool. A U.S. Governmental Accountability Office report estimated only 19 percent of federal student loan borrowers were taking advantage of income driven repayment programs in 2014.[15] In 2017, only 17 percent[16] of New York State federal student loan holders participate in an IDR loan repayment program.[17] The most recent statistics available from the Treasury Department suggest that 51 percent of Direct Loan borrowers were eligible for income based repayment, the dominant IDR plan, in 2012.[18] There is reason to believe a sizeable gap remains between eligible loan holders and participants in income-driven repayment programs – a gap that if closed could reduce the financial burden of these loans and avert loan defaults.

The Department of Consumer Affairs is concerned with the rising level of student loan debt and the outdated legal framework surrounding student loan discharge in bankruptcy. We appreciate the opportunity to express our concerns, share information, and present suggestions for future action.

Respectfully submitted,

Lorelei Salas, Commissioner

[15] https://www.gao.gov/assets/680/672136.pdf
[16] This statistic and the preceding include participation in all IDR plans
[17] Authors estimates based on https://studentaid.ed.gov/sa/about/data-center/student/portfolio
[18] https://www.gao.gov/assets/680/672136.pdf