Community Service Society

Powering a more equitable New York

MEMORANDUM IN SUPPORT OF BANKRUPTCY REFORM

FOR STUDENT LOAN BORROWERS

Submitted to the House Judiciary Subcommittee on the Administrative State,

Regulatory Reform, and Antitrust

By The Community Service Society of New York

Hearing Title: *Bankruptcy Law: Overview and Legislative Reforms*

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Introduction

The Community Service Society of New York (CSS) is a 180-year-old nonprofit committed to advancing economic opportunity for low- and moderate-income New Yorkers. In 2019, CSS launched the Education Debt Consumer Assistance Program (EDCAP), the first statewide initiative of its kind to provide direct help to student loan borrowers. EDCAP has since become a nationally recognized model, offering free, one-on-one assistance to borrowers navigating the student lending system.

Our work gives us a front-row seat to the devastating consequences of treating student debt as effectively non-dischargeable in bankruptcy. No other form of consumer debt is subjected to such rigid legal barriers. As Federal Reserve Chair Jerome Powell recently testified before Congress, "student loans should be dischargeable in bankruptcy like other debt." He's right. His statement affirms what we see every day: there is nothing inherently different about student loans that justifies their exceptional treatment. A fair and functional consumer credit system requires that student loans be treated like any other form of debt.

The federal government's extraordinary powers to collect on student loans, including wage garnishment, tax refund seizures, and offsets to Social Security and even disability benefits, make these debts some of the most punishing. Unlike other forms of consumer debt, federal student loans have no statute of limitations and can literally follow borrowers to the grave.

Meanwhile, business owners who take out millions and fail can walk away with a fresh start through bankruptcy. Our system allows this. But a person who took on debt to pursue a college education can remain trapped for life. The situation is especially unjust when the

borrower never completed the degree or never saw the promised economic mobility due to illness, job loss, wage stagnation, school malfeasance and now AI.

Consider the case of K.T., a retiree whose Social Security retirement benefits were being garnished to repay a federal student loan she took out in the 1970s. She had enrolled in college hoping to build a better life but was forced to leave school before completing her degree after becoming a single mother. Despite years of wage garnishments and Social Security offsets, her loan balance continued to grow due to a punitive default interest rate. K.T. had already repaid more than twice her original loan amount, but the debt still loomed. Her only wish was simple and deeply human: not to die in debt. Let that sink in. A woman who tried to better herself was punished for over five decades.

Lasting Human Toll from A Failed Bankruptcy System

Student loans were not always this unforgiving. Under the original 1977 Bankruptcy Code, student loans were treated like all other unsecured debts and were fully dischargeable. But in 1978, Congress began limiting discharge ability based on unfounded fears that students would abuse the system and file for bankruptcy.[1]

These fears were never supported by data, yet they triggered punitive changes:

- 1978: A five-year waiting period was introduced before student loans could be discharged. An "undue hardship" exception was added for earlier relief.[2]
- 1990: The waiting period was extended to seven years. Congress also barred Chapter 13 filers from including student loans in repayment plans without proving undue hardship.[3]

These changes, while technical, had devastating real-world consequences. S.M., for example, filed for bankruptcy in the 1990s and believed her student loans had been discharged. She rebuilt her life over the next two decades, only to learn that two of her loans had been just three months short of the seven-year threshold at the time of filing. She had never been informed and the federal government failed to collect on the debt. Her $25,000 balance ballooned to over $100,000. To settle, she withdrew from her modest retirement savings and paid accumulated interest, erasing years of financial security over an obscure administrative technicality.

[1] National Consumer Law Center, *Student Loan Law*, Chapter 15: *Discharging Student Loans in Bankruptcy.*
[2] Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, § 523(a)(8), 92 Stat. 2549 (Nov. 6, 1978) (establishing five-year waiting period after repayment commencement and including undue hardship exception).
[3] Pub. L. No. 101-647, § 3621(1), 104 Stat. 4789 (1990) (Extended the student loan waiting period under from five to seven years).

- 1998: Congress eliminated the waiting period entirely, leaving the undue hardship standard as the sole path to discharge for both Chapter 7 and Chapter 13 filers.[4]
- 2005: The Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA) extended these same restrictions to private student loans—even though they lack income-driven repayment options and other safeguards that come with federal loans.[5]

This progression made student loans the most protected and least forgiving form of consumer debt in the United States. It did not stop there.

Borrowers seeking to discharge student loans in bankruptcy must navigate a separate legal process known as an adversary proceeding. This process is complex, costly, and difficult to manage even with legal representation. The requirement alone causes widespread confusion and ongoing harm.

In 2022, the Biden Administration issued new guidance aimed at simplifying the process for discharging federal student loans.[6] However, the impact has been limited. As of July 2024, only about 1,220 cases had been filed, and 98% resulted in full or partial discharge under the new policy.[7] While the approval rate is encouraging, the number of cases is minuscule compared to the tens of millions of borrowers in distress and the looming wave of delinquencies and defaults the federal government faces, as many borrowers have yet to resume payments following the COVID-era pause. This stark contrast underscores just how broken the current system remains.

Even when borrowers go through bankruptcy but receive a partial discharge, they are often left in prolonged repayment under rigid stipulations. These arrangements can disqualify them from accessing income-driven repayment plans, loan forgiveness programs, or future loan consolidation. Worse still, a single misstep, like missing a payment, can trigger the reinstatement of the full original debt. In short, even those who "succeed" under the current system remain at risk of default and financial devastation. A partial discharge is not a fresh start but a half-measure that leaves borrowers vulnerable, burdened, and still trapped.

E.O., a long-time public-school educator, went through bankruptcy and believed her student loans had been addressed. Years later, she learned they were still active because she had never filed an adversary proceeding. Her loans remained "dormant" but fully

[4] Higher Education Amendments of 1998, Pub. L. No. 105-392 (Nov. 13, 1998) (eliminating waiting-period discharge, leaving undue hardship as sole path).
[5] Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8 (extending non-dischargeability absent undue hardship to private "qualified educational loans").
[6] Department of Justice & Department of Education, *Guidance for Department Attorneys Regarding Student Loan Bankruptcy Litigation* (Nov. 17, 2022) (introducing streamlined standardized procedures and attestation form).
[7] Press Release, *Justice Department and Department of Education Announce Continuing Success of Student-Loan Bankruptcy Discharge Process* (July 17, 2024) (reporting 1,220 filed cases since Nov. 2022 and 98% resulting in full or partial discharge).

collectible, with interest still compounding. Now approaching retirement, she still owes over $100,000. Retiring with this debt will be crippling.

Even when borrowers successfully navigate this process, the relief they receive is often partial, conditional, or easily revoked. A.S., a lifelong public librarian, was granted a partial discharge in 2002 for loans she defaulted on in the 1990s. But the terms of her stipulation were so harsh that they created a financial trap:

> *"If any one payment is more than thirty (30) days delinquent... this Stipulation shall become null and void, and all of the original terms of the Notes shall be in effect."*
>
> *"If Plaintiff consolidates the Notes... the stipulation shall become void... and the amount due under the original terms of the Notes shall be reinstated."*

In other words, missing one payment, or simply trying to consolidate her loans to become eligible for forgiveness programs, would trigger the reinstatement of her full original balance. For A.S., this meant her reduced $25,000 balance could balloon back to $150,000. Under the terms of her stipulation, she is expected to remain in repayment until January 2029, which is more than 25 years after receiving a partial discharge through bankruptcy.

Only in America can someone go through bankruptcy and still be locked into repayment for over two decades. This is not a fresh start but a prolonged sentence of financial insecurity.

The Rise of Private Student Debt

The recently enacted "Big Beautiful Bill" places new federal borrowing caps on graduate students and Parent PLUS borrowers. While intended to limit excess borrowing, these caps will have unintended consequences as more students and families will be forced into the private student loan market and face fewer protections and no way out.

Unlike federal loans, private student loans offer no income-driven repayment plans and generally no forgiveness programs. Yet, they must follow the same stringent bankruptcy rules. To discharge a private student loan, a borrower must still file an adversary proceeding and meet the undue hardship standard. This is inequitable.

Without meaningful reform, the combination of capped federal aid and inaccessible bankruptcy options will be catastrophic. Millions of borrowers will face a system that traps them and their families in unaffordable debt with no escape route. Student loans are already the second-highest form of consumer debt in the U.S., and private loans frequently require co-signers, dragging parents, grandparents, and even disabled relatives into lifelong financial jeopardy.

At EDCAP, we are already witnessing the early signs of this brewing crisis. Bankruptcy relief is functionally out of reach for many borrowers, especially those saddled with private loans.

Here are some case examples:

- J.B., a 21-year-old who dropped out of school due to serious mental health challenges, owes $54,000 in private student loans at 12.6% interest. Her $900 monthly payment is unmanageable, and her father and disabled grandmother—both co-signers—are now at risk. The crushing debt is worsening her mental health and threatening her family's financial stability.
- J.W., a civil servant in his 30s and father of two, owes $50,000 in private loans and supports two households following a divorce. Even with a $100,000 income, he cannot cover the payments. His mother, a co-signer, is now entangled in this debt. Neither bankruptcy nor restructuring are realistically available to them.

These cases highlight the multi-generational impact of private loans, and how co-signers become collateral in a system that provides no lifeline.

Conclusion

When it comes to student loans, we understand the importance of personal responsibility. We also recognize a common concern that taxpayers shouldn't have to foot the bill for someone else's education.

But what is too often forgotten is that borrowers are taxpayers. They are teachers, nurses, civil servants, veterans, caregivers, basically people working W-2 jobs, paying into the system, and contributing to our society every day. Yet when it comes to bankruptcy, they are treated differently. They face harsher rules, higher burdens, and fewer rights than any other group of debtors. We are not asking for special treatment for student loans. We are asking for equal treatment.

When an entrepreneur's business fails, they can seek relief through bankruptcy and start over. An American who pursued higher education should have the same opportunity.

At the Community Service Society of New York, through EDCAP, we meet borrowers every day who are doing everything right and still falling behind. They are not irresponsible. They are not trying to game the system. They are doing their best in a system stacked against them. A fair and functioning bankruptcy process must include student loan borrowers—federal and private alike. Anything less is not accountability. It's an injustice.

Congress must end the double standard and give borrowers the same chance we give everyone else, which is a real path to start over.

For questions or more information, please contact:

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