

STATUTORY CHANGE

Section 313 of the Bankruptcy Reform Act of 1994 (Pub. L. 103-394) added the following paragraph (c) to 11 U.S.C. 525:

(c)(1) A governmental unit that operates a student grant or loan program and a person engaged in a business that includes the making of loans guaranteed or insured under a student loan program may not deny a grant, loan, loan guarantee, or loan insurance to a person that is or has been a debtor under this title or a bankrupt or debtor under the Bankruptcy Act, or another person with whom the debtor or bankrupt has been associated, because the debtor or bankrupt is or has been a debtor under this title or a bankrupt or debtor under the Bankruptcy Act, has been insolvent before the commencement of a case under this title or during the pendency of the case but before the debtor is granted or denied a discharge, or has not paid a debt that is dischargeable in the case under this title or that was discharged under the Bankruptcy Act.

(2) In this section, 'student loan program' means the program operated under part B, D, or E of title IV of the Higher Education Act of 1965 (20 U.S.C. 1070 et seq.) or a similar program operated under State or local law.

[This change was effective on the date of enactment (October 22, 1994) and will apply to all applications for Title IV assistance received by schools, lenders, guaranty agencies, or the Department on or after that date.]

QUESTIONS AND ANSWERS

1. Is there a general rule that can summarize this statutory change?

Yes. A school, lender, guaranty agency, or the Department of Education, cannot consider a person ineligible for a Title IV loan, grant, or work study award *1* SOLELY because the person, or someone associated with that person, has filed for bankruptcy, owes a debt that is dischargeable in that bankruptcy proceeding, or has had a debt discharged in bankruptcy. However, as discussed in response to question #3, an applicant for Title IV assistance who has included a defaulted Title IV loan or grant overpayment that is NON-dischargeable in his or her bankruptcy schedules, will be considered ineligible for additional Title IV aid until he or she resolves the default or overpayment status.

When determining a Title IV applicant's eligibility for student financial assistance, if the applicant has filed a bankruptcy petition that lists a Title IV debt, the following sequence of questions may be helpful:

a. IS THE TITLE IV DEBT A DEFAULTED LOAN OF A GRANT OVERPAYMENT?

If YES, go to b. If NO, the applicant is eligible for all Title IV aid.

b. HAS THE DEBT BEEN DISCHARGED OR IS IT DISCHARGEABLE?

If YES, except for a parent applying for a PLUS loan (see question #7), the applicant is eligible for all Title IV aid. If NO,

the applicant must make satisfactory payment arrangements with the holder of the debt before being considered eligible for further aid.

Where an applicant seeks additional Title IV aid and has listed a non-dischargeable, defaulted Title IV loan or grant overpayment in a Chapter 7 bankruptcy filing, the holder of the Title IV debt can negotiate a satisfactory repayment arrangement at the request of the individual. Although bankruptcy law prohibits the holder of the defaulted loan or grant overpayment from taking collection action against a debtor, that individual remains ineligible for new aid under section 484(a)(3) of the Higher Education Act. Advising the applicant of that ineligibility and assisting an individual who wishes to cure that default status is not engaging in collection action prohibited by the Bankruptcy Code during a bankruptcy proceeding. The holder of the debt can determine what constitutes a satisfactory repayment arrangement for such an individual, as it would for any other person who owes a defaulted Title IV loan or grant overpayment.

An individual who lists a non-dischargeable, defaulted Title IV loan or grant overpayment in a bankruptcy filing under Chapter 11, 12, or 13 of the Bankruptcy Code would ordinarily cure his or her default status by providing for repayment of the debt under the plan proposed in the bankruptcy proceeding. The holder of the loan or grant obligation in these instances has limited ability to negotiate repayment terms, by objecting in the bankruptcy proceeding to the classification given the debt or to the amount of the debtor's disposable income to be devoted to payments under the plan. Regulations in the FFEL and Perkins Loan Programs describe the responsibilities of schools and guarantors to scrutinize and, under some circumstances, contest these issues. Subject to those requirements, however, the school or guarantor holding the loan must treat the repayment term and amount provided for in the debtor's plan as constituting satisfactory terms for a repayment agreement for purposes of requalifying the applicant for new Title IV aid.

2. What is meant by the term "a debt dischargeable in bankruptcy?"

This means subject to discharge under the Bankruptcy Code. Generally, a Title IV student loan or grant overpayment is NOT dischargeable unless the loan has been in repayment or the overpayment has been outstanding for at least 7 years, excluding any periods during which repayment has been suspended (for example, periods of forbearance or deferment), or the bankruptcy court determines that repayment of the debt would constitute an undue hardship to the debtor and his or her dependents.

Except when determining eligibility for a PLUS loan (see question #7), the dischargeability status of a non-Title IV debt included in a Title IV applicant's bankruptcy petition is ordinarily not of concern to a Title IV school, lender, or guaranty agency. However, the dischargeability of a Title IV debt, if it is a defaulted loan or a grant overpayment, is very important when determining the applicant's eligibility for additional Title IV aid (see question #1).

An individual seeking additional Title IV assistance who lists a defaulted Title IV loan or grant overpayment on his or her bankruptcy schedule, must obtain a written statement from the holder of the debt that states that the specific debt is dischargeable in bankruptcy because the debt has been in repayment for at least 7 years (excluding any periods during which repayment has been suspended) or, in cases

where the debt has not been in repayment for at least 7 years, that the applicant's hardship petition has been approved by the bankruptcy court. Title IV participants should rely upon information from the holder of the loan or grant overpayment claim, because the holder of the loan or grant overpayment claim is the party most likely to have reliable, authoritative records concerning either the duration of the repayment period or the possibility that a ruling was issued on undue hardship.

3. May a school, lender, or guaranty agency consider an applicant ineligible for a Title IV loan or grant because of an unpaid grant overpayment or a loan default status that existed prior to the applicant's bankruptcy filing with respect to a debt that was discharged or is dischargeable in that bankruptcy proceeding? Is the result different if the debt is non-dischargeable?

As explained in the general rule in question #1, except for a parent applying for a PLUS loan, the Bankruptcy Reform Act removed prohibitions against the receipt of Title IV aid that were based on an applicant's filing for relief in bankruptcy, obtaining a DISCHARGE, or failing to pay a DISCHARGEABLE or discharged debt. Therefore, the new bankruptcy law now prohibits a Title IV participant from refusing to consider an applicant eligible for a Title IV loan or grant because of a failure to repay a grant overpayment or a default on a loan that occurred prior to the applicant's bankruptcy filing on a debt that was DISCHARGED or is DISCHARGEABLE in bankruptcy.

If an applicant owes a defaulted Title IV loan or grant that is NON-dischargeable, and the applicant has not made satisfactory repayment arrangements with the holder of the debt, the applicant continues to be ineligible under section 484(a)(3) of the Higher Education Act for new Title IV aid. The new bankruptcy law does not exempt or excuse such an applicant, who must be treated the same as any other applicant for Title IV aid who owes a defaulted Title IV loan or grant overpayment.

4. Is reaffirmation of a Title IV loan previously discharged in bankruptcy still required as a prerequisite for an additional Title IV loan?

No. As of October 22, 1994, an applicant for a Title IV loan will not be required to reaffirm any previous Title IV debt that had been discharged in bankruptcy.

5. What is meant by the reference in the law to "another person with whom the debtor or bankrupt has been associated"?

This term includes any person with whom the Title IV applicant has (or had) a family, business, or personal relationship. Examples of such persons are endorsers on the promissory note and references on a loan application, or persons whose information is used on a student's need analysis form. However, as explained in question #7, a prospective endorser of a Federal PLUS or Federal Direct PLUS loan may be considered as being insufficiently creditworthy because of a previous or pending bankruptcy.

6. What action should the maker of a loan take if it learns that a borrower's bankruptcy schedules include a Title IV loan for which some (or all) of the loan disbursements are to be made after the date of filing?

A borrower who lists a loan not in repayment status in his or her bankruptcy filing, presumably is attempting to have the entire loan discharged in that bankruptcy proceeding.

A borrower is obligated to repay only those loan funds that have been received. When loan disbursements are received by the borrower after the filing of the petition, those disbursements are, with very limited exceptions, not subject to discharge. However, that does not ensure that a borrower who lists such a loan may not attempt, and even succeed, in obtaining a discharge. Furthermore, by seeking such a discharge, the borrower causes the filing of a guarantee claim by the lender and thus, a reinsurance payment by the Department to the guarantor.

To eliminate the possibility that a borrower would obtain a discharge or cause a guarantee claim to be filed by seeking a discharge of a loan disbursed after the borrower's bankruptcy filing, the Department urges lenders to take reasonable steps to ensure adequate identification of such loans. To do so, the Department strongly encourages lenders to make no disbursements on any loan applied for and approved before the borrower's bankruptcy filing, and to recall any disbursements not yet delivered to the borrower, if the lender agrees to make a new loan for the same amount that was not disbursed or was recalled on the cancelled loan, and so advises the borrower. In these cases, the lender will not be refusing to lend to the borrower on account of the bankruptcy, as prohibited by the new bankruptcy law, but is merely making the requested loan in a manner that documents the character of that loan as a loan made after the date of the borrower's bankruptcy filing, and therefore not dischargeable in that proceeding.

7. Will bankruptcy still be a factor in determining if an applicant for a Federal PLUS or Federal Direct PLUS loan has an adverse credit history?

Yes. An applicant for a PLUS loan under either loan program who has been the subject of a bankruptcy discharge during the 5 years preceding the date of the applicant's credit report, continues to be considered to have an adverse credit history,*² and thereby ordinarily not eligible for the loan. However, like any other PLUS loan applicant with an adverse credit history, such an applicant could still qualify for a loan if the applicant persuades the maker of the loan (and the maker documents its determination) that extenuating circumstances mitigated the adverse credit inference suggested by that filing or, in the absence of such circumstances, it agreed to make the loan on the condition that the applicant obtain a creditworthy endorser.

Taking into account the fact of a prior bankruptcy discharge in this manner does not violate bankruptcy law, because in so doing, the maker of the loan does not reject the loan applicant solely on account of the prior discharge, but remains willing to make the requested loan on the condition that the applicant satisfactorily rebuts the negative inference suggested by that prior discharge. The applicant can do so by demonstrating either that the loan, if not paid by the applicant, will be repaid by another individual who is creditworthy, or that the inference of lack of creditworthiness should not be drawn with respect to this particular applicant.

*¹ Although work study is not specifically mentioned in the statutory language, the Department believes that the amendment was intended to apply to all of the Title IV programs.

*² Pursuant to 34 CFR 682.201(b)(7) and §685.200(b)(7).