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Government Student Loans, Government Debts and Bankruptcy: A Comparative Study

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GOVERNMENT STUDENT LOANS, GOVERNMENT DEBTS AND BANKRUPTCY: A COMPARATIVE STUDY

*Stephanie Ben-Ishai**

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I. INTRODUCTION

Policy makers, post-secondary educational institutions, student groups and the media project an increase in the number and the value of loans for post-secondary education funded by the federal and provincial governments in Canada. This article provides a comprehensive review of the treatment of government-funded student loans in bankruptcy in Canada, considering the treatment in bankruptcy of loans funded by the government for a post-secondary education in a comparative context. In addition to Canada, the experiences of Australia, the United Kingdom, the United States and New Zealand are considered, as these jurisdictions have all witnessed a rapid increase in the number of overcommitted debtors, bankruptcies and reform to existing consumer bankruptcy legislation and policy over the last two decades. While the bankruptcy systems and funding structures of post-secondary education of these countries differ in certain important respects, each share some historical, institutional or procedural features with the Canadian bankruptcy regime and each jurisdiction has adopted some form of government-funded or guaranteed student loan program. In the last two decades increasing numbers of students in all of these jurisdictions have pursued post-secondary education, tuition fees have risen, and government-funded student loans have replaced government grants as the primary means for lower and middle income students to fund post-secondary education.

A review of the current position and historical trajectory of the treatment of government student loans in bankruptcy in Canada, Australia, England, the United States and New Zealand suggests that all five jurisdictions are converging on a model where the bankruptcy system provides limited to no relief for loans transacted under a program funded or guaranteed by a government unit to fund a post-secondary education. This article argues that the two key justifications relied upon to justify this model — student abuse of the bankruptcy process and the need to protect the public interest — are unsubstantiated. The evidence from Canada and from all of the other jurisdictions under review demonstrates that students are not abusing the bankruptcy process. The evidence also demonstrates that, with the exception of the United States, government-funded student loans are the only government debts that are excepted from the bankruptcy discharge. This is contrary to the trend in every jurisdiction under review to remove the special treatment

previously accorded to Crown debts. Further, given the growth of securitization markets for student loans, private investors in fact are benefiting from the special treatment accorded government-funded student loans in bankruptcy, though such special treatment is justified as necessary to protect the public interest.

Because the justifications for the current exception to the bankruptcy discharge for government-funded student loans are not well founded, this article does not advocate tweaking the waiting period for the exception to discharge for government-funded student loans. Rather, reform efforts should be directed at the substantive and procedural aspects of the exception. The process for making decisions about these features must be informed by empirical data. Adopting this approach, the article suggests that the current exception to discharge for government-funded student loans in Canada should be abolished. The current system, which places the onus on the bankrupt to apply to the court and demonstrate good faith and financial hardship, is ineffective due to procedural obstacles relating to the onus and substantive obstacles relating to the role of bankruptcy registrars. The onus should be placed on the government to oppose a discharge where the bankrupt has not experienced financial hardship in repaying government-funded student loans and/or where there is evidence of bad faith.

Part II of this article outlines the basic structure of government-funded student loans in Canada, the treatment of these loans in bankruptcy, and recent proposals for reform. Part III outlines both the measures that led to a pattern of convergence in the treatment of government-funded student loans in bankruptcy in the common law jurisdictions under review and the triggers for these measures. Within this comparative context, the soundness of the recommendations generated from two recent Canadian government reports on bankruptcy and the provisions found in Statute c. 47 are considered in Part IV together with recommendations and issues that need to be further explored in considering these proposals and new legislation.

II. CANADIAN CONTEXT

A central facet of the Canadian consumer bankruptcy system in its current form is an individual's right to a "fresh start" provided by the bankruptcy discharge. Following bankruptcy an individual is free from most of her debts and at the same time retains her experiences, knowledge and values, often referred to as human

capital,¹ which can contribute to her becoming a productive member of society again. However, a number of exceptions to the bankruptcy discharge are provided for under existing legislation.² These exceptions apply to both bankruptcies and consumer proposals under the Bankruptcy and Insolvency Act (BIA). While a literature has developed around the justifications for a mandatory, or non-waivable, bankruptcy discharge, a comprehensive normative theory of the appropriate scope of the discharge and accompanying exceptions has eluded commentators for some time. A common explanation for this list of exceptions is that they all concern fraud or similar misbehaviour against creditors and excluding these categories of bankrupts from discharge is intended to deter this conduct. However, the list excludes a large number of “wrongdoers”, such as bankrupts who have committed torts other than the three that are identified by the act. In particular, bankrupts who owe tax and non-tax debts to the government, such as unemployment insurance overpayments or small business loans, are not included on the list. There is no obvious rationale for this list of debts.

Government Student Loans³ are found on the existing list of exceptions to discharge.⁴ The inclusion of Government Student Loans was justified on the basis that without the exception to discharge, a significant number of students were blatantly manipulating the bankruptcy system by finishing their post-secondary studies, and then going bankrupt to erase their Government Student Loans before profiting from professions such as law or medicine.

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1. “You cannot separate a person from his or her knowledge, skills, health or values the way it is possible to move financial and physical assets while the owner stays put.” Gary S. Becker, *Human Capital, A Theoretical and Empirical Analysis with Special Reference to Education*, National Bureau of Economic Research (University of Chicago Press, Chicago, 1993), p. 16.
 2. Bankruptcy and Insolvency Act, R.S.C. 1985, c. B-3, s. 178(1) (BIA). The debts identified in this section include fines imposed by a court; alimony, maintenance or support payments owing; damages awards arising from civil proceedings for bodily harm, sexual assault or wrongful death; debts and liabilities arising out of fraud; and government student loans.
 3. A “Government Student Loan” is any debt or obligation in respect of a loan made under the Canada Student Loans Act, R.S.C. 1985, c. S-23, the Canada Student Financial Assistance Act, S.C. 1994, c. 28 or any enactment of a province that provides for loans or guarantees of loans to students. This includes loans made by private banks participating in government student loan programs.
 4. BIA, *supra*, footnote 2, s. 178(1)(g).

1. Overview of Government Student Loans⁵

In Canada, students who cannot afford the cost of a post-secondary education rely on a range of credit products to fund their studies. Many students (and parents) use lines of credit, extended mortgages, private loans and credit cards to fund their education. The only form of student credit that is not based on a positive past-credit history, and accordingly is most accessible to students from low and middle-income families, is a Government Student Loan. Government Student Loans are issued based on assessed student need, and do not charge interest while students are engaged in part- or full-time studies. In 2003, 42% of all post-secondary students relied on federal Government Student Loans.⁶ Of these students, 58.8% were women and 41.2% were men.⁷ Approximately 16.8% of the student borrowers represented high-need part-time students, high-need students with permanent disabilities, females pursuing doctoral studies or students with dependents.⁸

Government Student Loans are provided to students based on federal-provincial partnerships in nine provinces and in the Yukon.⁹ In these participating jurisdictions, provincial and territorial student assistance offices administer the front end of both provincial and federal student loans. Generally, students hold two separate Government Student Loans: a provincial loan and a federal loan. However, pursuant to Canada-Provincial Integrated Student Loan Agreements,¹⁰ four provinces — Ontario, Saskatchewan, New Brunswick and Newfoundland — have integrated their student loan

5. This introduction to the Canadian context for government student loans draws heavily from S. Ben-Ishai, "One Paradox of the Bankruptcy Fresh Start: Government Student Loans" (2005), *Ann. Insolv. Rev.* 436.

6. Human Resources and Skills Development Canada, *Student Loans Program Annual Report 2002-2003* (2004), online at <http://www.hrsdc.gc.ca/en/hip/cslp/publications/12_pu_AnnualReport20022003.pdf> at p. 2 (Annual Report).

7. *Ibid.*, at p. 3.

8. *Ibid.*, at p. 20. These are students who are eligible to receive Canada Study Grants (CSGs) from the federal government. Information on the specific percentage of students falling in each category is not provided in the Canada Student Loans Program 2002-2003 Annual Report. CSGs are non-repayable and accordingly a detailed discussion of their operation is beyond the scope of this article.

9. Quebec, Northwest Territories and Nunavut have opted out of the federal student loan program and receive alternative payments to operate their own programs.

10. Edulinx Canada Corporation, online at Canada-Provincial Integrated Student Loans <http://www.edulinx.ca/index.php?option=com_content&task=view&id=57&Itemid=58> (date accessed: July 19, 2005).

programs with the federal program such that students receive only one loan funded by both the federal and provincial governments. The integrated loan is subject to the terms of the federal student loan program.

The federal government directly finances all federal student loans issued on or after August 1, 2000 through the National Student Loans Service Centre (NSLSC).¹¹ Provincial or territorial student assistance offices review both federal and provincial loan applications, confirm eligibility, assess financial need, and determine the amount of funding students will receive. The NSLSC processes loan documents, arranges for loan funds to be deposited to the student's bank account, keeps track of the total amount of the loan throughout the student's studies and the amount she will have to repay, sets up a loan repayment schedule, and administers debt-relief programs. Under the current scheme, there is no maximum repayment period, but a typical repayment period is 9.5 years.¹² Students are entitled to a six-month grace period after leaving part or full-time studies before having to make payments on their loan.¹³ However, interest accrues on the loan during the grace period.¹⁴ Following the grace period, for provinces that have not reached Canada-Provincial Integrated Student Loan Agreements, students are required to consolidate their provincial and federal

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11. The government, through the NSLSC, contracts out the administration of the program, including debt relief options, to two private service providers. Edulinx administers loans issued to students attending not-for-profit universities and colleges and BDP administers loans issued to students enrolled in training programs offered by for-profit companies. Nelnet, Inc. acquired Edulinx from the Canadian Imperial Bank of Commerce (CIBC) for an undisclosed price on November 30, 2004. Edulinx services approximately one million Government Student Loans totaling approximately \$7 billion. The company was originally established in 1999. CIBC became the sole owner of Edulinx in January 2002. A significant part of Nelnet's business is the securitization of education finance assets: see online at <www.shareholder.com/Common/Edgar/1258602/930413-05-3765/05-00.pdf>. Edulinx sub-contracts with Canada Post to handle the processing of loan documents and the depositing of funds into students' accounts. See Canadian Federation of Students, Membership Advisory, "Latest Changes to the Canada Student Loan Program" (March 2001), online at Membership Advisory <<http://www.cfs-fcee.ca/html/english/research/factsheets/ma-200103-cslp.pdf>> (date accessed: July 20, 2005) at p. 1 (Membership Advisory).
 12. Interview of L. Wanczycki, Policy Advisor (June 27, 2005) Canada Student Loan Program, Human Resources and Skills Development Canada. This information was not available on the NSLSC website or guide.
 13. Canada Student Loans Act, R.S.C. 1985, c. S-23, s. 5.
 14. *Ibid.*, s. 4(2)(b).

student loans and to decide on a fixed or floating rate of interest to repay their loans.¹⁵

Following the 1998 federal budget, the government introduced a number of forms of relief, which are still in place today, for students having trouble repaying their Government Student Loans due to financial hardship. Prior to regulatory changes enacted in 2004 and 2005, these options were extremely limited, only available to borrowers with loans in good standing and imposing very low income thresholds. The 2004 Amendments replaced the good standing requirement for obtaining relief with more lenient specific eligibility requirements and also increased the amount of available relief.¹⁶ The 2005 Amendments raised the income thresholds for obtaining relief by 5% and also further increased the amount of available relief.¹⁷ While the 2004 and 2005 Amendments have extended eligibility and increased the amount of assistance provided through the government's debt relief programs, the requirements for obtaining relief remain complex and the income thresholds remain relatively low. It is still too early to determine the impact of these amendments.

Interest relief represents the central form of relief for debtors with Government Student Loans.¹⁸ Interest does not accrue while a borrower receives interest relief. This form of relief is based on gross family income, family size, and the principal owing on student loans. Interest relief is typically granted for six-month periods, up to a maximum of 30 months, throughout the lifetime of the loan. Extended interest relief,¹⁹ which is available to students who are unable to make payments within five years of leaving school,

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15. The current federal fixed interest rate is prime plus 5%, while the floating rate is prime plus 2.5%. Students have the option to change to a fixed rate at any time. See Human Resources Development Canada (HRDC), Evaluation of the Canada Student Loans Program, "Introduction" (February 23, 1999), online at Human Resources Development Canada <http://www11.hrdc-drhc.gc.ca/pls/edd/CSL_55028.htm> (date accessed: April 21, 2005) at para. 11.
 16. SOR/2004-120 (effective May 11, 2004) (2004 Amendments).
 17. SOR/2005-152 (effective August 1, 2005) (2005 Amendments).
 18. Canada Student Financial Assistance Act, s. 7 and Canada Student Financial Assistance Regulations: SOR/95-329, s. 19. See also National Student Loans Service Centre, online at Integrated Interest Relief <<http://www.canlearn.ca/NSLSC/support/new/nlwhanew3.cfm?langnslsc=en>> (date accessed: April 25, 2005) (Integrated Interest Relief).
 19. Canada Student Financial Assistance Act, *ibid.*, and Canada Student Financial Assistance Regulations, *ibid.*, ss. 19-20. See also Integrated Interest Relief, *ibid.*

extends interest relief benefits up to an additional 24 months. The government may also agree to a revision of terms²⁰ and extend the loan repayment period or reduce monthly payments for a short period of time.

Two other “last resort” forms of debt relief are available to students: the Debt Reduction in Repayment Program and the Permanent Disability Benefit. Under the Debt Reduction in Repayment Program, where a student has exhausted all other avenues and has been out of school for five years, she may apply to have her loan principal reduced. If approved for the program, she could be eligible to receive an initial reduction of up to \$10,000; if she continues to experience financial difficulty, she may apply for a second and a third reduction in amounts of up to \$10,000 and \$6,000 respectively.²¹ The total availability of \$26,000 in debt reduction represents an increase from the \$10,000 maximum in place prior to the 2004 and 2005 Amendments. In order to qualify for benefits under the Debt Reduction in Repayment Program, a student must have used all 30 months of benefits under the interest relief plan; must be in good standing with the NSLSC and/or her financial institution, with not more than two months in arrears owing on her debt; and her loan payments must exceed a given percentage of her income, as established by the Debt Reduction in Repayment Income Table appended to the Canada Student Financial Assistance Regulations.²² If a student has a permanent disability, and is experiencing exceptional financial hardship in repaying her loan due to the disability, she may also qualify for the Permanent Disability Benefit, where all or a portion of her Government Student Loan is forgiven.²³

20. National Student Loans Service Centre, online at Revision of Terms <<http://www.canlearn.ca/nslsc/repay/On/nlObtRepAss.cfm?LANGNSLSC=en&IT=PUBLIC&row=3>> (date accessed: April 25, 2005).

21. Canada Student Financial Assistance Regulations, *supra*, footnote 18, s. 42.1. See also National Student Loans Service Centre, online at Debt Reduction in Repayment <<http://www.canlearn.ca/nslsc/repay/On/nlObtRepAss.cfm?LANGNSLSC=en&IT=PUBLIC&row=5>> (date accessed: April 25, 2005).

22. *Ibid.*

23. Canada Student Financial Assistance Regulations, *ibid.*, s. 43.1(1)(b). See also National Student Loans Service Centre, online at Permanent Disability Benefit <<http://www.canlearn.ca/nslsc/repay/On/nlObtRepAss.cfm?LANGNSLSC=en&IT=PUBLIC&row=6>> (date accessed: April 25, 2005).

For provinces that have not reached Canada-Provincial Integrated Student Loan Agreements, there are some variations between the federal debt relief options and the provincial debt relief options for repayment of Government Student Loans. For example, under the Alberta Loan Relief Program, enacted on August 1, 2001, students who receive more than \$5,000 per year in combined Alberta and federal loans may qualify for relief. Financial assistance above \$5,000 may be provided as a loan relief benefit, which is not repayable.²⁴ In Manitoba, the maximum amount of debt reduction is \$6,667 compared to \$26,000 now available for federal loans.²⁵ In Nova Scotia, students must apply for debt reduction within three months of graduation. The percentage of debt reduction is graduated based on completed year of study and ranges from 15% to 45%. In addition, borrowers may qualify for an employment bonus award or repayment bonus award and receive an additional 25% or 10%, respectively, of the amount of debt reduction they received at graduation.²⁶

Until May 11, 2004, when the 2004 Amendments came into effect, students who filed a proceeding under the BIA were not eligible for new federal Government Student Loans and they could not obtain the benefits of the federal government's debt relief programs for existing Government Student Loans. A student who files a proceeding under the BIA may now be eligible to obtain Government Student Loans for a maximum of three years, provided she remains in the same program of study and continues in full-time status, and she may also be eligible for the government's debt relief programs.²⁷

2. Proposals and Reforms

In the last five years a number of proposals have been put forward to increase the number and the value of student loans provided

24. Edulinx Canada Corporation, online at Repayment Assistance — Provincial and Territorial Loans <http://www.edulinx.com/index.php?option=com_content&task=view&id=55&Itemid=64> (date accessed: July 20, 2005) (Edulinx).

25. *Ibid.*

26. Nova Scotia Department of Education — Student Loans (Student Assistance), online at Debt Reduction Program Information <http://studentloans.ednet.ns.ca/student_debt_reduction.shtml> (date accessed: July 20, 2005).

27. 2004 Amendments, *supra*, footnote 16. See also Office of the Superintendent of Bankruptcy Canada, "Notice of Changes to the Regulations Under the Canada Student Loan Program", online at Office of the Superintendent of Bankruptcy <<http://strategis.ic.gc.ca/epic/internet/inbsf-osb.nsf/en/br01439e.html>> (date accessed: August 4, 2005).

by the federal and provincial governments as well as to amend the current legislation pertaining to the treatment of these loans in bankruptcy.

The most recent recommendation has flowed from a report commissioned by the Ontario government, in response to the 2004 Ontario budget's commitment to review the design and funding of postsecondary education in Ontario. Premier Dalton McGuinty appointed the Honourable Bob Rae as the advisor to the Premier and the Ministry of Training, Colleges and Universities, who with the support of a seven-member advisory panel, was asked to advise on two issues: the design of a publicly funded postsecondary system and funding models for this system. The government released the Rae Review in February 2005.²⁸ The report, which has attracted significant attention around the country, recommended that the current freeze on tuition fees in place in Ontario should be lifted and that individual institutions should be free to set their own tuition.²⁹

28. B. Rae, *Ontario A Leader in Learning: Report & Recommendations* (February 2005) (Rae Review).

29. See, for example, a sample of the numerous newspaper articles on the topic following the release of the Rae Review: "Rae Review's Funding Flaw", *The Toronto Star*, February 21, 2005, p. A17; I. Robertson, "Students Fight Fees; Even Rae Comes Under Fire", *The Toronto Sun*, February 4, 2005, p. 4; B. Whitwham, "Summerlee Doesn't Expect Surprises in Rae Review", *The Guelph Mercury*, February 5, 2005, p. A1; P. George, "Value of Universities Reflected in Many Ways", *The Hamilton Spectator*, February 5, 2005. See also Ontario, Legislative Assembly, *Excellence Accessibility Responsibility: Report of the Advisory Panel on Future Directions for Postsecondary Education* by D.C. Smith (Chair) (1996), online at Ministry of Education and Ministry of Training, Colleges and Universities <<http://www.edu.gov.on.ca/eng/document/reports/futuree.html#sharing>> (date accessed: July 20, 2005). Historically, Newfoundland, Nova Scotia, Prince Edward Island, Saskatchewan and Alberta have not regulated tuition fees. New Brunswick and Manitoba occasionally imposed tuition regulations. Prior to the 1990s, Ontario, British Columbia and Quebec regulated tuition fees. See Canadian Federation of Students, Fact Sheet 1998 5:5, "Deregulation of Tuition Fees" (November 1998), online at Deregulation of Tuition Fees <[http://www.cfsontario.ca/policy/factsheets/fs-5\(5\)-deregulation.pdf](http://www.cfsontario.ca/policy/factsheets/fs-5(5)-deregulation.pdf)> (date accessed: July 20, 2005), pp. 3-4. Similar to Ontario, British Columbia deregulated tuition fees in 2002. However, in the 2005 Throne Speech, the government announced that it would be re-regulating tuition fees, after fees more than doubled during the period of deregulation. Tuition fees will be capped at the rate of inflation. See Canadian Federation of Students, Media Release, "Campbell Second-Guesses BC Tuition Fee Policy" (February 9, 2005), online at Media <http://action.web.ca/home/cfs/en_alerts.shtml?x=72136> (date accessed: July 20, 2005). The Ontario example, which is demonstrative of national tuition fee trends and debates, is used to develop the context for the focus of this report on student loans in bankruptcy. This article focuses on the Ontario context because it recently provoked

The position of the Rae Review was justified by a condition precedent for tuition fees to be raised: more students should be eligible for government-subsidized financial assistance.³⁰

The status of Government Student Loans in bankruptcy also received significant attention in the two recent Canadian government reports on bankruptcy: the Personal Insolvency Task Force Report published in December 2002³¹ and the Senate Report published in November 2003.³² Both reports advocated reforms to address the current exception to the bankruptcy discharge for Government Student Loans, which provides for limited relief on financial hardship grounds, on an all-or-nothing basis, following a costly court application that is only possible 10 years after the bankrupt or former bankrupt has ceased to be a full- or part-time student.³³ Both reports referenced empirical data³⁴ that detailed the dire financial circumstances of bankrupts with student loans relative to those without student loans and demonstrated that such bankrupts were generally not high-income professionals attempting to defraud the system. Further, the reports indicated that the existing legislation was ill-equipped to address intervening life events such as illness, disability and family breakdown, which often

significant national scrutiny. A detailed review of tuition trends around the country is beyond the scope of this article.

30. Rae Review, *supra*, footnote 28, at p. 23.
31. Office of Superintendent of Bankruptcy Canada, *Personal Insolvency Task Force Final Report* (August 2002), online at <http://www.strategis.ic.gc.ca/epic/internet/inbsf-osb.nsf/en/h_br01225e.html> (date accessed: August 5, 2005).
32. Canada, Standing Senate Committee on Banking, Trade and Commerce, *Debtors and Creditors Sharing the Burden: A Review of the Bankruptcy and Insolvency Act and the Companies' Creditors Arrangement Act* (Ottawa, 2003), online at Senate of Canada <<http://www.parl.gc.ca/3712/parlbus/commbus/senate/com-e/bank-e/rep-e/bankruptcy-e.pdf>> (date accessed: August 4, 2005).
33. Where a student returns to school after the 10-year period has commenced, the clock is restarted.
34. See S. Schwartz, "The Dark Side of Student Loans: Debt Burden, Default, and Bankruptcy" (1999), 37 Osgoode Hall L.J. 317, for a summary of this data at p. 329: The economic situation of all those declaring bankruptcy suggests that bankruptcy is used primarily as a last resort. The economic situation of those seeking bankruptcy protection with student loans among their debts, or whose student loans were critical in their bankruptcy, is even worse than the already desperate situation of the whole group. To be sure, they are younger and have more education, but they have lower annual household income and lower monthly income at the time of filing for bankruptcy. More than 40 per cent had received income assistance in the two years previous to filing, and about 30 per cent had received unemployment insurance. A surprisingly large portion — more than one-third — had occupations that were unskilled.

accounted for unpaid Government Student Loans and warranted a fresh start. To this end, both reports recommended that the exception to discharge for Government Student Loans should be amended to apply only to situations where it had been less than five years since the bankrupt completed full- or part-time studies that the loans had funded. As well, both reports recommended that courts be provided with the discretion to confirm the discharge of all or a portion of a Government Student Loan before the five-year period had lapsed, in cases where the bankrupt could establish that the burden of maintaining the liability for some or all of the debt would result in financial hardship.

The 10-year exception to discharge has also been met with a great deal of criticism by bankruptcy trustees and student groups. Bankruptcy trustees, concerned with the impact the 10-year exception has on their ability to come up with a reasonable solution to debtors' financial distress, have criticized the exception as unduly harsh.³⁵ Student groups supported what was ultimately an unsuccessful legal action to challenge the exception under the equality provisions of the Canadian Charter of Rights and Freedoms.³⁶

In the last year, two bills have been introduced that attempt to vary the timing of the exception to discharge for Government Student Loans. On October 20, 2004,³⁷ Alexa McDonough (Halifax, NDP) introduced Bill C-236,³⁸ which would have amended the BIA to "reduce, from ten to two years after a bankrupt leaves school, the period of time during which an order of discharge does not release the bankrupt from the reimbursement of his or her student loan".³⁹

35. See for example, Hoyes and Michalos, online at Canada and Ontario Student Loans in Bankruptcy <http://www.hoyes.com/student_loan_bankruptcy_Canada.htm> (date accessed: August 4, 2005).

36. See Canadian Federation of Students, "Bankruptcy Charter Challenge" (April 2005), online at Campaigns & Lobbying <http://www.cfs-fcee.ca/html/english/campaigns/bankruptcy_charter.php> (date accessed: April 26, 2005). The decision was released on June 30, 2005: *Chenier v. Canada (Attorney General)*, 2005 CanLII 23125, 12 C.B.R. (5th) 173, 131 C.R.R. (2d) 361 (Ont. S.C.). Justice Sedgwick held that the exception was not based on an individual's "needs, merits or capacities". He was not convinced that the exception does anything more than distinguish between Government Student Loan debtors and other debtors on the grounds of the nature of the debt. Justice Sedgwick described outstanding Government Student Loans as reflecting an economic condition and not a personal characteristic.

37. *House of Commons Debates*, 012 (October 20, 2004) at p. 1525 (Ms Alexa McDonough).

38. Bill C-236, An Act to amend the Bankruptcy and Insolvency Act (student loan), 1st Sess., 38th Parl., 2004.

39. *House of Commons Debates*, 065 (February 25, 2005) at p. 1300 (Ms. Alexa McDonough).

The bill was subsequently defeated in a motion held on April 13, 2005.⁴⁰

Most recently, on June 3, 2005, the federal government, in Bill C-55, unveiled a package of long-awaited amendments to Canadian bankruptcy legislation entitled An Act to establish the Wage Earner Protection Program Act, to amend the Bankruptcy and Insolvency Act and the Companies' Creditors Arrangement Act and to make consequential amendments to other Acts.⁴¹ Bill C-55 made its way through the parliamentary process on an expedited basis and received Royal Assent on November 25, 2005, and is now Statute c. 47.⁴² Statute c. 47 reduces the period for the exception to discharge for Government Student Loans from 10 years to seven years following the completion of full- or part-time studies.⁴³ The statute also reduces the period of time before an application for relief from the exception to discharge can be made from 10 years to five years.⁴⁴ Similar to Bill C-236 and the government reports that have recommended changes to the timing of the exception, Statute c. 47 does not provide a principled amendment to the substance of the exception. For example, the statute leaves intact the requirement that a

40. *House of Commons Debates*, 081 (April 13, 2005) at p. 1525 (Hon. Peter Milliken).

41. Bill C-55, An Act to establish the Wage Earner Protection Program Act, to amend the Bankruptcy and Insolvency Act and the Companies' Creditors Arrangement Act and to make consequential amendments to other Acts, 1st Sess., 38th Parl., 2005 (first reading in House of Commons June 3, 2005).

42. See *Debates of Senate*, 142 (November 25, 2005) at p. 1100. The Office of the Superintendent of Bankruptcy reported on the process:

Given the extraordinary circumstances that existed with the impending dissolution of Parliament, the Standing Senate Committee on Banking, Trade and Commerce requested and received the Government's assurance that Bill C-55 would not be proclaimed in force prior to June 30, 2006, at the earliest. It is expected that as soon as possible in 2006, the Government will refer the matter to the Standing Committee for study. Following its review last week, the Standing Committee reported that it expects to receive from Industry Canada officials a list of legislative and regulatory changes to improve Bill C-55 and Canada's insolvency regime. The Standing Committee further reported that it expects to provide an opportunity to all stakeholders to share their views on key aspects of the legislation. The exact scope of possible amendments is as yet unknown. It is clear, however, that any additional review by the Senate may impact on the timing of the coming into force of the legislation.

See Office of the Superintendent of Bankruptcy Canada, "Bill C-55 Receives Royal Assent", online at <<http://strategis.ic.gc.ca/epic/internet/inbsf-osb.nsf/en/br01561e.html>> (date accessed: December 8, 2005).

43. *Ibid.*, s. 107(2): "Subparagraph 178(1)(g)(ii) of the Act is replaced by the following: (ii) within seven years after the date on which the bankrupt ceased to be a full- or part-time student."

44. *Ibid.*, s. 107(3):

bankrupt submit a judicial application for relief following the waiting period, in order for any relief from the exception to be granted.

III. MEASURES TOWARDS CONVERGENCE AND TRIGGERS

1. More Restrictive Discharge Provisions

In Australia, the United States, the United Kingdom and New Zealand, students have met with increasing difficulty in discharging their government-funded student loans. Only in New Zealand and, in a more limited way, Australia, can government-funded student loans still be discharged in bankruptcy.

Of these countries, the United States was the first to create an exception to discharge for government-funded or guaranteed student loans. In 1976, Congress enacted the nondischargeability provision in response to claims that recent graduates were abusing the bankruptcy system by eradicating their debts immediately upon graduation.⁴⁵ Originally, there were two exceptions to the nondischargeability provision that applied to student loans: a debtor could discharge the loans in a Chapter 7 bankruptcy proceeding if five years had lapsed after the loan matured or if the debtor could establish undue hardship.⁴⁶ These exceptions were included in response to criticisms regarding the lack of empirical evidence of abuse and to preserve the spirit of the Bankruptcy Code.⁴⁷ The five-year exception was later extended to seven years, but was subsequently abolished by The Higher Education Amendments in 1998.⁴⁸ Today, the only remaining relief from the exception to discharge for student loans is the undue hardship provision. This is the case for both a Chapter 7 and a Chapter 13 proceeding. Most recently, on April 20, 2005, the government passed an amendment that extends the

Subsection 178(1.1) of the Act is replaced by the following: (1.1) At any time after five years after a bankrupt who has a debt referred to in paragraph 1(g) ceases to be a full- or part-time student, as the case may be, under the applicable Act or enactment, the court, may on application, order that subsection (1) does not apply to the debt if the court is satisfied that (a) the bankrupt has acted in good faith in connection with the bankrupt's liabilities under the debt; and (b) the bankrupt has and will continue to experience financial difficulty to such an extent that the bankrupt will be unable to pay the debt.

45. B. Hennessy, "The Partial Discharge of Student Loans: Breaking Apart the All or Nothing Interpretation of 11 U.S.C. 523 (A)(8)" (2004), 77 *Temp. L. Rev.* 71 at p. 73.

46. *Ibid.*, at p. 118.

47. *Ibid.*

48. C. Morea, "Student Loan Discharge in Bankruptcy — It is Time for a Unified Equitable Approach" (1999), 7 *Am. Bankr. Inst. L. Rev.* 193 at note 2.

nondischargeability provision.⁴⁹ While the provision previously applied only to government and non-profit student loans, it now includes student loans issued by for-profit entities.⁵⁰ The United States is the only jurisdiction under review to have extended the application of the exception to discharge to non-government funded or guaranteed student loans.

The U.S. Congress did not define what constitutes “undue hardship”, but rather left it open to the judiciary to construct an appropriate definition. The American courts have developed increasingly complex tests to determine what constitutes “undue hardship” that have provided limited relief to applicants. According to Jennifer Frattini, “the formation of various stringent judicial interpretations of ‘undue hardship’ . . . have the effect of undermining the first goal of bankruptcy — providing the honest, overburdened debtor with a fresh start”.⁵¹ A recent empirical study of the 261 reported undue hardship decisions issued by U.S. bankruptcy courts, within the 10-year period spanning from 1994 to 2003, demonstrated few statistically significant differences in the factual circumstances of debtors granted a discharge as opposed to those who did not receive this relief.⁵² Less concerned with the frequency with which relief was granted, the authors of this empirical study focused on the judicial process and the small number of debtors who had the financial wherewithal to litigate a claim of undue hardship.⁵³ The authors observed that nearly half of the discharge determinations analyzed concluded that failing to discharge a debtor’s student loans would impose undue hardship on the debtor.⁵⁴ However, the authors criticized the haphazard fashion in which courts determined whether a debtor’s circumstances supported a claim of undue hardship.⁵⁵

In Canada, in 1997, Government Student Loans were made nondischargeable in bankruptcy if the bankrupt had been out of

49. The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, § 220, 119 Stat. 23 at 59 (to be codified at 11 U.S.C. § 523(a)(8)(B)).

50. *Ibid.*

51. J. Frattini, “The Dischargeability of Student Loans: An Undue Burden?” (2001), 17 Bank. Dev. J. 537 at p. 541.

52. R. Pardo and M. Lacey, “Undue Hardship in the Bankruptcy Courts: An Empirical Assessment of the Discharge of Educational Debt” (Tulane University School of Law, Public Law and Legal Theory Research Paper Series, Research Paper No. 05-06, August 2005).

53. *Ibid.*

54. *Ibid.*

55. *Ibid.*

school for less than two years.⁵⁶ A debtor could apply to the court for a discharge of her debts after the two-year period if she could demonstrate that she had acted in good faith and could not repay her loan due to financial difficulty.⁵⁷ Government Student Loans incurred outside the two-year period were treated in the same way as other unsecured debts and discharged. In 1998, this two-year exception to discharge was increased to 10 years, making it even more difficult for students to discharge their student loans.⁵⁸ A critique similar to that levelled against the manner in which U.S. courts have dealt with judicial applications for relief has been put forward in Canada.⁵⁹

The most recent jurisdiction to exempt government-funded student loans from the bankruptcy discharge is the United Kingdom. In 2004, the United Kingdom enacted the Higher Education Act 2004,⁶⁰ which removed government-funded student loans from the bankruptcy realm.⁶¹ Prior to 2004, student loans were provable and could be discharged in bankruptcy.

2. Government Student Loans Not Provable

In Australia, prior to the introduction of the Higher Education Support Act 2003, government-funded semester and accumulated student loan debts were provable but not extinguished in bankruptcy. With the introduction of the Higher Education Support Act 2003, these loans were classified as non-provable. Bills Digest No. 159, pertaining to the Higher Education Funding Amendment Bill 2001, states that since the Commonwealth retains the prospect of repayment because these loans are not extinguished in bankruptcy, the government should not be able to claim a share of the sale of the bankrupt's assets and thus reduce the amount available to other creditors who have no future hope of repayment.⁶² Accordingly, subsequent reforms to the Bankruptcy Act 1966 that reference the Higher Education Support Act 2003 exempt semester and accumulated student debts completely from the operation of bankruptcy.

56. An Act to Amend the Bankruptcy and Insolvency Act, 1997, c. 12 (Bill C-5).

57. *Ibid.*

58. Budget Implementation Act, 1998, S.C. 1998, c. 21, s. 103, amending the BIA.

59. Ben-Ishai, *supra*, footnote 5.

60. Higher Education Act 2004 (U.K.), 2004, c. 8, s. 42 (hereinafter HEA).

61. *Ibid.*

62. Higher Education Funding Amendment Bill 2001 (Cth.), Bill Digest No. 159 (2001).

The treatment of assessment debts remains unchanged; they are provable and extinguished in bankruptcy.

Similarly, in the United Kingdom, one rationale advanced by the House of Commons Standing Committee on March 9, 2004, in support of the treatment of government-funded student loans under the Higher Education Funding Act 2004, was that classifying student loans as non-provable would make available more money to other creditors.⁶³

3. Perceived Abuses of the Bankruptcy System

In all of the countries under review, the most influential rationale for the introduction of more restrictive discharge provisions regarding student loans was the claim that the bankruptcy process was susceptible to abuse by students who were eager to rid themselves of their loans prior to embarking on lucrative careers. A further trend is that these allegations of abuse have rarely been substantiated.

In the United Kingdom Margaret Hodge, the former Minister of Lifelong Learning and Higher Education, initiated and supported legislative reforms that effectively eliminated bankruptcy as an option for debt relief for outstanding government-funded student loans, based on apprehension of potential abuse. She was concerned that students viewed bankruptcy as an easy route to avoid repaying student loans.⁶⁴ On March 9, 2004, the House of Commons Standing Committee acknowledged that the number of students claiming bankruptcy had increased dramatically, from eight in 1992 to 899 in 2003.⁶⁵ However, the committee further acknowledged that the number of students claiming bankruptcy amounted to less than 1% of the total number of students with government-funded loans.⁶⁶ These statistics did not support the contention that the bankruptcy process was in jeopardy of being abused. Nevertheless, the House of Commons Standing Committee advanced this rationale in support of the recent legislative reforms.

Similarly, in 1976, the U.S. Congress enacted a nondischargeability provision to “ensure the viability of student loan programs by preventing students with fraudulent intentions from deliberately abusing the bankruptcy system by incurring massive loan obligations,

63. U.K., H.C., *Standing Committee Debates*, col. 578 (March 9, 2004) (Mr. Willis).

64. *Ibid.*, col. 572.

65. *Ibid.*, col. 571.

66. *Ibid.*, col. 577.

obtaining a free education, then filing a petition to have all their debts wiped out".⁶⁷ Opponents of the nondischargeability provision for government student loans noted that there was little empirical evidence of abuse. The cases of fraudulent abuse were rare, but were sensationalized by the media.⁶⁸ A study by the General Accounting Office, conducted prior to the implementation of s. 523(a)(8), revealed that only a fraction of 1% of matured student loans had been discharged in bankruptcy.⁶⁹

In Canada, similar concerns about abuse prompted the introduction of the two-year nondischargeability provision for student loans. For example, Mr. Brian Tobin, during Proceedings of the Standing Senate Committee on Banking, Trade and Commerce, stated, "We are trying to avoid situations where someone declares bankruptcy simply to get rid of their student loan and then finds a job."⁷⁰ No empirical data has been put forward to justify this contention. Rather, empirical data has demonstrated that this is not the case.⁷¹

With the introduction of the Higher Education Loan Programme (HELP) in Australia, a greater number of students had access to student loans. There was a fear that as more students acquired loans the instances of abuse would increase.⁷² Therefore, one rationale for exempting semester and accumulated student debts from the bankruptcy process was to mitigate these potential instances of abuse.⁷³ Again, no empirical data was put forward to justify this concern.

In New Zealand, the Student Loan Scheme was enacted to support the government's social and economic goals for higher education. Since 1990, education policy has required students to contribute more to the costs of their education. The shift toward greater student contribution is based on the increased demand for higher education, increased costs incurred to meet this demand and pressure to reduce government spending. An argument is also advanced that the student, who receives the benefits from higher education, should be required to pay more for those benefits.⁷⁴ However,

67. Frattini, *supra*, footnote 51, at p. 541.

68. Hennessy, *supra*, footnote 45, at p. 74.

69. *Ibid.*

70. Canada, Senate, *Proceedings of the Standing Senate Committee on Banking, Trade and Commerce*, "Issue 13 – Evidence" (November 4, 1996) (Mr. Tobin).

71. Schwartz, *supra*, footnote 34.

72. Interview of B. Cruickshanks, Insolvency and Trustee Services Australia (May 31, 2005).

73. *Ibid.*

74. New Zealand, "Student Loans and Funding for Tertiary Education" (November 5, 1999), Parliamentary Library.

punitive aspects remain in the New Zealand bankruptcy process: the inability to obtain funding under the Student Loan Scheme, the requirement of consent from the Official Assignee or the court before leaving New Zealand, restrictions on employment in certain positions and restrictions on obtaining credit over \$100. Based on these onerous conditions and the lack of empirical evidence to suggest that students are currently abusing the bankruptcy process, no attempts have been made to introduce an exception to discharge for student loans under the Student Loan Scheme. At the same time, in the context of the proposed “no-asset procedure”, because there is less stigma, a shorter term and fewer restrictions than bankruptcy, there is a fear that students will resort to the process only to discharge their student debt. The government predicts that by preventing the discharge of student loan debt under the Student Loan Scheme in a “no-asset procedure”, 250 debtors will be affected.⁷⁵ All other provable debts (apart from debts which are non-dischargeable in bankruptcy, such as child maintenance orders) will be dischargeable through the “no-asset procedure”.⁷⁶

4. Increasing Number and Value of Student Loans

In all of the countries under review, claims surrounding abuse of the bankruptcy process by students proliferated with an increase in the number and the value of government-funded student loans. This fear-of-increasing-abuse rationale led, in all countries except New Zealand, to the enactment of nondischargeability provisions as a response to the rising number and value of student loans, and the expected rise in associated defaults.

As noted above, leading up to the enactment of the nondischargeability provision in the United Kingdom in 2004, the number of students claiming bankruptcy had dramatically increased from eight in 1992 to 899 in 2003.⁷⁷ There were also proposals to increase

75. See New Zealand Ministry of Education, “A Guide to the Student Support Changes” (May 2004), online at A Guide to the Student Support Changes <http://www.minedu.govt.nz/web/downloadable/d19643_v1/9643-student-support-guide.pdf> (date accessed: August 4, 2005).

76. See Ministry of Economic Development, “Draft Insolvency Law Reform Bill: Discussion Document” (April 2004), online at Draft Insolvency Law Reform Bill: Discussion Document <<http://www.med.govt.nz/ri/insolvency/review/draft-bill/discussion/index.html>> (date accessed: August 4, 2005).

77. *Supra*, footnote 63, col. 571.

tuition fees and abolish upfront fees, which would necessitate the need for greater student loan support.⁷⁸ In anticipation of this increased demand, the United Kingdom opted to exempt student loans from bankruptcy.

In Canada, prior to the introduction of the nondischargeability provision in 1997, the number of student loan defaults increased from only 9% in 1980 to 17% in 1990.⁷⁹ In 1997 when the nondischargeability provision was introduced, the government had reportedly lost \$70 million in 1996-1997 from Government Student Loans in bankruptcy, up from \$30 million in 1990-1991.⁸⁰ In 1990-1991, 223,505 full-time students received federal Government Student Loans with an average value of \$2,863.⁸¹ In comparison, in 1996-1997, 343,224⁸² full-time students received federal Government Student Loans with an average value of \$4,615.⁸³ This represented an increase of 53.6% in the number of borrowers and a 61.2% increase in the average value of the loans received during that period.

In the United States, the Bankruptcy Reform Act of 1978 first excepted student loans from bankruptcy. One goal of the Bankruptcy Reform Act of 1978 was to rescue "the student loan program from fiscal destruction".⁸⁴ From 1978 to 1981, the percentage of students with student loans more than doubled from 15%

78. L. Dearden et al., *Higher Education Funding Policy: Who Wins and Who Loses? A Comprehensive Guide to the Current Debate* (London, The Institute for Fiscal Studies, 2005), p. 1.

79. Schwartz, *supra*, footnote 34, at p. 317.

80. *Ibid.*, at p. 318.

81. Human Resources and Skills Development Canada, "Evaluation of the Canada Student Loans Program" (1997), online at Profile of Canada Student Loan Program <<http://www.hrsdc.gc.ca/asp/gateway.asp?hr=/en/cs/sp/edd/reports/1997-000340/page06.shtml&hs=cxp>> (date accessed: August 4, 2005) (HRSDC).

82. Human Resources and Skills Development Canada, "Number of Canada Student Loans Borrowers for 1996-1997 (Full-Time Students Only)", online at Canada Student Loans Program Statistics <http://www.hrsdc.gc.ca/asp/gateway.asp?hr=/en/hip/cslp/statistics/03_st_Borrowers1996.shtml&hs=cxp> (date accessed: August 4, 2005).

83. Human Resources and Skills Development Canada, "Average Dollar Amount of Negotiated Canada Student Loans (CSL) Full-Time Students Only", online at Canada Student Loans Program Statistics <http://www.hrsdc.gc.ca/asp/gateway.asp?hr=/en/hip/cslp/statistics/10_st_DollarAmount.shtml&hs=cxp> (date accessed: August 4, 2005).

84. R. Roots, "The Student Loan Debt Crisis: A Lesson in Unintended Consequences" (2000), 29 Sw. U.L. Rev. 501 at p. 512.

to 33%.⁸⁵ Federal outlays for the program grew from \$500 million in 1978 to \$2.3 billion in 1981.⁸⁶ Legislative amendments,⁸⁷ which promoted increased accessibility to higher education and raised tuition fees charged by colleges,⁸⁸ prompted the increase in student loans.

Although New Zealand still permits government-funded student loans to be discharged in bankruptcy, the government is currently experiencing an increase in the number of student loans that are written off each year. In 2002, total student debt owing to the government amounted to over \$5 billion, with only one in ten students debt-free.⁸⁹ The New Zealand University Students' Association estimates that by 2020 total student debt in New Zealand will rise to almost \$20 billion, an amount the country's Auditor General believes could be "potentially a major source of risk" to New Zealand's national government.⁹⁰ In June 2004, \$8.5 million in student loans was written off for 542 borrowers compared to \$3.5 million for 326 borrowers in June 2003.⁹¹

5. Protecting the Public Interest: Recipient of Benefit Should Pay

The legislative debates and government reports coming out of the countries under review reveal a consensus that students, as the primary beneficiaries of higher education, should be required to contribute to the cost of their education through tuition fees. This line of reasoning has been used in the bankruptcy context to claim that students should not be able to skirt these contributions by using bankruptcy to discharge loans incurred to cover the costs of education. Policies that oblige students to contribute financially to their

85. *Ibid.*, at p. 506.

86. *Ibid.*

87. *Ibid.*, at p. 505. See for example, the Higher Education Act 1965, 1965 PL 89-329, and the Middle Income Student Assistance Act, 1978 PL 95-566 (which extended student loan benefits to Americans regardless of household income. Prior to that only households with an income of less than \$25,000 were eligible for loans under the *Higher Education Act*: *ibid.*, at note 19).

88. *Ibid.*

89. New Zealand University Students' Association, "The Student Loan Scheme: Inequities and Emerging Issues" (Wellington, 2002).

90. *Ibid.*

91. New Zealand, "Annual Report Student Loan Scheme" (October 2004), online at Annual Report Student Loan Scheme 2004 <<http://www.studylink.govt.nz/pdf/2004/sls-annual-2004.pdf>> (date accessed: August 5, 2005) at p. 34 (Annual Report N.Z.).

education and prohibit the discharge of student loans in bankruptcy are justified on the basis of protecting the public interest, namely taxpayer dollars that are used to finance student loan programs.

In the United Kingdom, for example, the rationale for the Labour Party's proposal to increase tuition fees is that students, who derive substantial benefits from their education, should be required to contribute to the cost of their education.⁹² The Labour Party is also recommending a variable fee rate that reflects the different economic benefits derived from various courses of study.⁹³ Furthermore, in support of the Higher Education Act 2004, which effectively removed student loans from bankruptcy, the House of Commons Standing Committee expressed concerns about protecting the public interest, specifically taxpayer dollars that are used to fund the student loan program.⁹⁴

In Australia, prior to 1989, students were not required to pay any tuition fees. John Dawkins, the Labour Minister of Education at the time, believed that this policy constituted an unfair subsidy to the rich by the poor.⁹⁵ Therefore, the Australian government enacted a system of deferred contributions, which required students who stood to benefit from their education to pay a portion of the cost.⁹⁶ Directly linked to this system was the creation of a partial exception to discharge for outstanding student contributions.

In the United States and Canada, rhetoric similar to that used in the United Kingdom and Australia surrounding the private benefit of an education may be found in the legislative debates. In addition, American and Canadian courts have often invoked this rhetoric in denying judicial applications for relief. In the United States, courts often consider whether the student benefited from her education when determining whether the debtor has satisfied the undue hardship test.⁹⁷ If a debtor has secured employment in her chosen field, it is less likely that the court will grant a discharge of the debtor's student loans.

92. U.K., Secretary of State for Education and Skills, "The Future of Higher Education" (By Command of Her Majesty, 2003) at p. 83.

93. *Ibid.*

94. *Supra*, footnote 63, col. 578.

95. A. Usher, *Much Ado About a Very Small Idea: Straight Talk on Income Contingent Loans* (Toronto, Educational Policy Institute, 2005), p. 3.

96. *Ibid.*

97. Frattini, *supra*, footnote 51, at pp. 553 and 566.

In Canada, the Honourable Bob Rae has stated,

While there is unquestionably a significant social benefit to higher education that should be recognized by a stronger commitment to public funding, there is also an important private benefit to the student and the graduate. It is only reasonable for students to pay part of the cost. Otherwise we would be asking taxpayers who don't go [to university or college] to subsidize those who do.⁹⁸

In the bankruptcy context, in some instances Canadian courts have translated this sentiment into a consideration of whether a debtor has derived an economic benefit from her education when determining if an application for relief from the exception to discharge should be granted. For example, in *Allen (Re)*,⁹⁹ the applicant was denied a discharge because she had secured employment in her chosen field and thus had derived an economic benefit. However, in *Swann (Re)*,¹⁰⁰ the applicant was not successful at obtaining employment in her chosen field and therefore was granted a discharge. The application of this principle has, however, been inconsistent and the courts have often overlooked other life circumstances that impact financial hardship. For example, in *Allen (Re)*, the court downplayed the fact that, although the applicant had obtained employment, she suffered from a disability that prevented her from working full-time hours.¹⁰¹

6. Development of Securitization Markets

In both the United States and the United Kingdom, the ability to access public capital markets to fund government-funded and guaranteed student loans through securitization has played a role in shaping an increasingly restrictive exception to discharge for student loans. It is the case that in the context of student loan securitization, increasing the restrictive exception for discharge would only be expected to have a positive impact on funding costs if student loan defaults were a material problem. To this point in the article it has been argued that there is no justification for the claim that such defaults are a material problem. The argument that is made here with respect to securitization is based on the emergence of a powerful new set of stakeholders involved in the securitization

98. Rae Review, *supra*, footnote 28, at pp. 23-24.

99. *Allen (Re)*, 2000 CarswellOnt 4167 at para. 6 (Gen. Div.).

100. *Swann (Re)*, 2001 CarswellBC 1959 at para. 12 (Master).

101. *Allen*, *supra*, footnote 99, at para. 3.

industry. This “new” group of stakeholders is relying on the unsupported rhetoric and perception surrounding student loan default to push for an increasingly restrictive exception as an alternative or concurrent strategy with building the perceived probability of default into existing pricing models.

In the United States, the existence of a securitization market likely played a role in extending the exception to private student loans, and in the United Kingdom, in introducing an exception for government-funded student loans. The American asset-backed securities market is the world’s largest, although the asset-backed securities market has been growing rapidly around the globe. Australia, New Zealand, Canada and the United Kingdom, for example, have all witnessed the introduction of asset-backed securities. However, currently only the United States and the United Kingdom appear to have developed markets for the securitization of student loans. Canada appears to be moving in the direction of developing a securitization market for student loans.

Securitization of student loans refers to the process where an entity pulls together student loans and then sells the rights to those receivables to investors in the form of securities.¹⁰² This process generally takes place through the establishment of a trust, referred to as a special purpose vehicle, which acquires the student loans from the originators of the student loans.¹⁰³ The trust then issues debt securities or other interests to investors,¹⁰⁴ which are secured by the student loan notes acquired, related government guarantees and/or subsidies of the student loans. The cash that the trust receives from investors is used to pay the originator of the loans for the loans purchased.¹⁰⁵ The trust collects the cash generated by loans and distributes it to security holders over time.¹⁰⁶

Securitization is beneficial to transferors because they can obtain funds at a more favourable interest rate that does not take into account the bankruptcy risk of the originator of the loans.¹⁰⁷ Rather than considering the credit rating of the originator of the loans,

102. J.L. Debruin, “Corporate Law: Recent Developments in and Legal Implications of Accounting for Securitizations” (1999), *Ann. Surv. Am. L.* 367 at p. 368.

103. *Ibid.*, at p. 369.

104. *Ibid.*

105. Dominion Bond Rating Service, online at US Student Loan ABS <<http://www.dbrs.com/web/sentry?COMP=2900&DocId=147792>> (date accessed: July 15, 2005) (DBRS).

106. *Ibid.*

107. Debruin, *supra*, footnote 102, at p. 370.

investors need only look to the cash flow from the loans themselves in evaluating the risk for the investment.¹⁰⁸ An equally important reason for originators of loans to engage in securitization is the favourable accounting treatment of such transactions.¹⁰⁹ Off-balance-sheet financing rules allow the transferor to increase liquidity and lower the debt-to-equity ratio as a result of the transaction.¹¹⁰

In the United States, securitization of government guaranteed student loans amounted to a \$34 billion business in 2004.¹¹¹ Capital markets do not play a direct role in directly financed government student loans in the United States.¹¹² A number of secondary market institutions are involved in purchasing and packaging for sale student loans from originators of government guaranteed student loans who choose not to keep the loans on their books.¹¹³ The Student Loan Marketing Association (Sallie Mae) is both the largest issuer of student loan asset backed securities and the largest private source of funding, delivery and servicing for student loans in the United States.¹¹⁴ Sallie Mae issues student loan asset backed securities backed by both government guaranteed and private student loans.¹¹⁵ In 2004, Sallie Mae issued 12 deals totaling approximately \$26 billion.¹¹⁶ Nelnet Education Loan Funding Inc., which recently purchased Edulinx, the entity contracted to service federal and some provincial Government Student Loans in Canada, stood next in line with four deals totaling over \$5 billion.¹¹⁷

Initially when the U.K. government introduced tuition fees, the government offered students mortgage-style loans. In five years it had built up a debt portfolio of £3 billion. The U.K. government faced a similar challenge to the one that Canadian governments will face if there is a move from our current mortgage-style government-funded student loan system to an income-contingent model: What should be done with the existing loans? In 1998 and 1999, the U.K.

108. *Ibid.*

109. *Ibid.*, at p. 371.

110. *Ibid.*

111. DBRS, *supra*, footnote 105.

112. *Ibid.*, at p. 2.

113. *Ibid.*

114. Nomura, "Student Loan ABS 101" (January 26, 2005), online at <http://www.securitization.net/pdf/Nomura/StudentLoan_26Jan05.pdf> (date accessed: August 8, 2005) at p. 8.

115. *Ibid.*, at p. 9.

116. *Ibid.*

117. *Ibid.*

government addressed this question by selling £2 billion of the U.K. government's student loan portfolio to the private sector. Each transaction involved the sale of approximately £1 billion in student loans owing to the government.¹¹⁸ In both instances, the Student Loan Company Limited, a non-profit company, wholly owned by the U.K. government, was contracted to administer the portfolios. One of the contracts to service the student loans sold to the private sector was renewed and the other was discontinued in 2004.¹¹⁹ The 1998 transaction involved the securitization of student loans. In that transaction 300,000 student loans granted to those who entered post-secondary education before September 1, 1998 were transferred to Honours Student Loans, a special purpose vehicle set up by Honours Trustee Limited, a company formed jointly by Deutsche Bank and the Nationwide Building Society.¹²⁰ Honours Trustee Limited paid £1 billion to the U.K. government for these loans.¹²¹ Given that the Student Loan Company Limited operates as a business and must account to the Department of Education and Skills for its performance, the accounting treatment resulting from the sale of the student loans was likely a key motivating factor in the sale of the student loans.

IV. RECOMMENDATIONS AND ISSUES FOR FURTHER CONSIDERATION

This section puts forward recommendations and issues for further consideration concerning the justifications for the exception to the bankruptcy discharge, the reform process and the substance of reforms to the current exception. These recommendations have been formulated with a view to the pattern of convergence in the treatment of government-funded student loans in bankruptcy that has been observed in the common law jurisdictions under review, as well as the events and circumstances that have triggered legislative measures in those jurisdictions. It is important to note at the outset that Canada appears to be the only jurisdiction that is taking seriously proposals to make the exception to discharge in bankruptcy for student loans less restrictive. For this reason, the other countries

118. Student Loan Company, "Annual Report and Accounts 2003-2004, Delivery in the Future", online at Annual Report 2003-2004 <<http://www.slc.co.uk/pdf/annual-report2004.pdf>> (date accessed: August 4, 2005) at p. 3.

119. *Ibid.*

120. J. Cumbo, "Former Students Confused by Loan Switch", *Financial Times*, November 5, 2004.

121. *Ibid.*

under review are paying close attention to the Canadian proposals and developments. Accordingly, the implications of Canada's choices are far-reaching and hold significance beyond the national context.

Current policy and legislative proposals for reforming the treatment of student loans in bankruptcy in Canada merely attempt to tweak the waiting period attached to the exception and the ability to make an application for relief. Absent from these proposals and legislation is a consideration of the substantive features of the exception and an evaluation of the justifications for these features. In particular, current proposals and legislation do not address the soundness of the key premises underlying the current exception: (a) student abuse of the bankruptcy process; and (b) the need to protect the public interest. The findings in this article suggest that these premises are unfounded. Provision is made in Statute c. 47, and supported by earlier government reports, for reduction in the waiting period for the inapplicability of the exception and for obtaining relief from the exception. In the short term, this may resolve some of the tensions in the existing system. However, this does not represent a long-term solution.

1. Recommendations

(a) Public Interest and Abuse Justifications for Exception are Unsubstantiated

A common theme in each of the jurisdictions considered, except New Zealand, is the political motivation behind the introduction or increased restrictiveness of the exception to discharge for government-funded or guaranteed student loans: the exception to discharge makes more palatable the figures documenting the rising costs of post-secondary education. Ironically, the increase in the number and value of student loans is the direct result of the goal of democratizing post-secondary education. Policy-making in the bankruptcy context has operated in opposition to this goal by discounting the social gains of an education and constructing education as a private benefit. The move to impose an increasingly restrictive discharge has followed from anecdotal stories about alleged abuses offered by politicians and those representing certain private interests, even in the face of the availability of empirical data that suggests such stories are either altogether apocryphal or

relate to a statistically insignificant number of cases. Saul Schwartz's study provides a good empirical platform in the Canadian context to challenge these stories.¹²² Similarly, a review of all the reported applications for relief from the exception to discharge provides an alternative source of narratives that also challenges the dominant accounts of student abuse in the bankruptcy process.¹²³

Directly linked to accounts of student abuse used to justify the current exception are claims that because the government is the creditor at issue, it is in the public's interest for the government to be given special treatment for these debts. This public interest justification has been rejected in numerous jurisdictions that have recently dispensed with the Crown's priority status in bankruptcy. While historically Crown priority for payment of debts was rooted in the theory that the "King could do no wrong", this principle is being abandoned globally.¹²⁴ In this context, claims centred on the protection of the public purse have been discounted on the grounds that if a debtor cannot obtain a fresh start (or in the corporate context — reorganize) the debtor will not be able to pay future debts to federal, provincial and local governments and will become a burden on them. There is a growing recognition that the quality of neighbourhoods, communities, the environment and retirement may be at stake in decisions as to whether to protect the public purse by abolishing or granting Crown priority.

Importantly, in the current context, as is discussed in the section on securitization above, any special treatment based on the public interest flowing from the government's identity as the creditor needs to be carefully evaluated. In the American context, the identity of the government as the creditor was used to justify an exception for student loans that has just been expanded to private lenders outright. On this basis, the National Bankruptcy Conference opposes the amendment to the nondischargeability provision. Specifically, the conference has stated: "The justification typically provided for excepting government insured loans from discharge does not apply to private loans made by for-profit institutions. For-

122. Schwartz, *supra*, footnote 34.

123. Ben-Ishai, *supra*, footnote 5.

124. For a broader discussion of these reforms and the current status of the government in bankruptcy in Canada see S. Ben-Ishai, "Technically the King Can Do Wrong in Reorganizing Insolvent Corporations: Evidence from Canada" (2004), 13 *Intl. Insolv. Rev.* 1 (Ben-Ishai 2004).

profit institutions extend credit at market rates and on the same basis as every other lender."¹²⁵

Originally, one justification for the current nondischargeability provision was to provide protection to non-profit and governmental entities, so that they could issue student loans and not harm the public purse.¹²⁶ When the amendment to expand the exception to "for profit" lenders was first proposed, the American Bankers Association and Consumer Bankers Association Task Forces on Bankruptcy asserted, "this proposed change simply suggests that if sufficient political pressure can be generated, a special interest group can obtain special treatment under the bankruptcy law".¹²⁷ Similarly, in the United Kingdom, the sale of directly funded government student loans to the private sector likely played a role in introducing the exception to discharge for these loans.

Given the involvement of Nelnet Education Loan Funding Inc. with the federal government student loan program and a number of provincial student loan programs in Canada, it appears that the development of a securitization market for these loans is imminent. Careful consideration needs to be given to the benefits of accessing public markets in this way. In particular, it will be necessary to evaluate whether such a market may be created without an exception to discharge for Government Student Loans. The U.K. model suggests that this is possible. The securitization of government-funded student loans in the U.K. took place prior to the introduction of an exception to discharge for government-funded student loans. At the same time, it is likely that once the securitization market was created, the private entities involved in this market played a significant role in shaping the policy that led to the enactment of the exception to discharge for government-funded student loans. In the United States, which has the most developed securitization market, the private entities involved in this market played a significant role in shaping the exception to discharge that now includes private student loans.

In the Canadian context, the role that players in the securitization market will have in shaping bankruptcy policy must be considered. An argument can be made that investment in student loans through

125. Report of National Bankruptcy Conference on Titles I-III of the Bankruptcy Legislation, 2001 WL 770326, 96 (Nat'l Bankr. Confr. 2001), cited in Hennessy, *supra*, footnote 45.

126. Hennessy, *ibid.*, at p. 92.

127. H.R. Rep. No. 95-595, at 150 (1977), reprinted in 1978 U.S.C.C.A.N. 5963, 6111 cited in Hennessy, *ibid.*, at p. 92.

the securitization market serves the public interest in increasing liquidity in the student loan market and increasing the total funding available to make student loans. However, there are a number of criticisms that can be levelled against the securitization of student loans. Importantly, we do not want to find ourselves in a situation where the driving force in developing bankruptcy policy is the issue of how best to facilitate the securitization market at the expense of taking into account the implications for other stakeholders impacted by these policies. For example, along the same line, student groups in Canada have argued that the 1998 amendment to the Canadian exception to discharge can be attributed to the banks' participation in the federal student loan program during this period and the government's desire to appease them.¹²⁸

(b) Abolish the Exception

In light of the findings that the two key justifications for the exception to discharge for Government Student Loans are unsubstantiated, this section puts forward the argument that the exception to discharge should be abolished. The onus should be placed upon the government to oppose discharges where financial hardship would not result from continued payment of Government Student Loans and/or where bad faith can be demonstrated. In this way, the nine-month bankruptcy period could be extended where appropriate and a model more akin to the model in place in Australia and in New Zealand may be implemented. A key benefit of this approach is that bankruptcy registrars would be relieved of their role in making decisions surrounding student hardship that they currently must make in applications for relief from the exception.

The Canadian model attempts to achieve what the Australia and New Zealand system accomplish through a longer bankruptcy process and the possibility for administrative hearings related to student hardship through the tax system. However, it fails for two reasons. First, with the 10-year waiting period, the exception introduces an inconsistency in the duration of the bankruptcy process for debtors with student loans and debtors without student loans. In Australia and New Zealand, because bankruptcy is a three-year period, the same concerns surrounding quick downloading of student loans through bankruptcy do not exist. The 10-year waiting

128. Membership Advisory, *supra*, footnote 11, at p. 2.

period before students can apply for relief from the exception to discharge attempts to address this concern in the Canadian context. However, unlike the approach taken in New Zealand and Australia, this is inconsistent with the decision on the length of the bankruptcy process. That is, at a minimum in Canada the bankruptcy period for bankrupts with student loans is essentially 10 years compared with the nine-month period for most bankrupts.

A second problem with the exception is that it places on bankruptcy registrars the burden of making decisions about student hardship, without providing any guidance as to how to make these decisions. In jurisdictions such as Australia, such decisions are administrative decisions under the taxation scheme, for which there is a large body of precedent on which to draw. Bankruptcy registrars in Canada have no such body of precedent for student loan decisions. No other exception to the bankruptcy discharge in Canada provides for an exception to its application on good faith and financial hardship grounds. For these reasons and because of the procedural and substantive obstacles in bringing an application for relief, the current role played by bankruptcy registrars is ineffective. Given both the American and the Canadian experience with applications for relief from the exception, where decisions are inconsistent and limited relief is provided, a better approach would be to place the onus on the government to oppose a former student's discharge in appropriate cases.

The proposed approach is essentially a return to the Canadian model in place between 1992 and 1997. In 1992, the government's preferred status in bankruptcy was removed, consistent with a broader trend in other jurisdictions to limit the priority status of the Crown.¹²⁹ When the preference was taken away from the government, the government argued that there was little to be gained from objecting to a bankrupt's discharge since it had to share any recovery with the bankrupt's other unsecured creditors. The government claimed that it experienced significant losses as a result of its general unsecured position and the increasing number of students who were going bankrupt with unpaid Government Student Loans. As has already been discussed, the data demonstrate that while default on student loans and bankruptcies may increase with an increasing number and value of student loans, there is no empirical evidence

129. For a broader discussion of this reform and the current status of the government in bankruptcy see Ben-Ishai 2004, *supra*, footnote 124.

of abuse of the bankruptcy process. Accordingly, closing the door to bankruptcy as a means to confront the costs associated with democratizing post-secondary education is not the solution. Further, unlike the situation prior to 1997, mandatory surplus income payments are now required for high-income debtors during the nine-month bankruptcy period¹³⁰ and Statute c. 47 will extend that period.¹³¹ While the government would have to share any recovery with other unsecured creditors, the possibility for greater recovery remains through income contributions during the bankruptcy period, which for high-income debtors looks similar to lengthier bankruptcy periods in Australia and New Zealand. Further, while this approach may result in increased monitoring and litigation costs in relation to student loans, these costs would presumably outweigh the costs of distress suffered by existing students who cannot discharge their Government Student Loans.

As there were few cases between 1992 and 1997 where the government opposed a bankrupt's discharge on account of unpaid Government Student Loans, it is difficult to evaluate the role that bankruptcy registrars played in that period in relation to student loans. In order to avoid an unpredictable and inconsistent system if the exception is abolished, the government must issue a bulletin as to its policy and criteria for opposing discharges on the ground of outstanding Government Student Loans.

2. Issues for Further Consideration

(a) The Provability of Government Student Loans

An issue that has not arisen in the Canadian context concerns the provability of Government Student Loans; it is unclear from a review of both primary and secondary sources why this issue has not been addressed. One possibility is that where Government Student Loans are in a bankrupt's portfolio of debts, the distribution from the bankrupt's estate to unsecured creditors is so low that the issue does not have much economic significance. This possibility

130. See An Act to Amend the Bankruptcy and Insolvency Act, the Companies Creditors' Arrangement Act and the Income Tax Act, S.C. 1997, c. 12 and Office of the Superintendent of Bankruptcy Canada, *Directive No. 11: Surplus Income* (issued October 30, 2000 and revised January 26, 2005), online at Office of the Superintendent of Bankruptcy <<http://strategis.ic.gc.ca/epic/internet/inbsf-osb.nsf/enbr01055e.html>> (date accessed: June 14, 2005).

131. *Supra*, footnote 41, s. 58.

warrants further investigation in the current context. The rationale behind the approach in Australia and in the United Kingdom suggests that if the exception for Government Student Loans is retained in Canada, the loans should not be provable in bankruptcy. That is, since the government retains the prospect of repayment because student loans are not extinguished in bankruptcy, it should not be able to claim a share of the sale of the bankrupt's assets, thereby reducing the amount available to other creditors who have no future hope of repayment.

(b) The Treatment of Government Student Loans in a No-Asset Procedure

It may be argued that the summary administration process, currently in place under the BIA, is Canada's version of a no-asset bankruptcy procedure. However, this process still includes a number of features that distinguish it from the proposed no-asset processes in New Zealand and the United Kingdom. One of the most significant of these features is the high financial cost of going bankrupt in Canada. If the Canadian exception to discharge for Government Student Loans were to be abolished, such a decision to abolish might subsequently require further consideration if a no-asset procedure, similar to the U.K. or New Zealand model, is implemented in Canada.

V. CONCLUSION

Drawing attention to the projected increase in the number and the value of loans for post-secondary education funded by Canadian federal and provincial governments, calls for reform to their treatment in bankruptcy, and other jurisdictions' recent considerations of the issue, this article set out to accomplish two goals. First, this article has taken stock of a series of significant reforms over the past decade with respect to the treatment of government-funded or guaranteed student loans in the bankruptcy systems under review. Second, given the options for dealing with student loans in bankruptcy presented by these other jurisdictions, and Canada's willingness to reassess its own choices, a number of recommendations and issues for further exploration are put forward. In light of the experiences of Canada and the other jurisdictions under review this article's central recommendation relates to the conceptual framework for considering the Canadian model for dealing with student loans

in bankruptcy. That is, the two key justifications for the current exception to discharge for government-funded student loans, student abuse of the bankruptcy process and the need to protect the public interest, should be put to rest, as they are unsubstantiated.