Issue Paper 1
Session 1: November 13-15, 2017

Issue: Whether to establish a Federal standard for the purpose of determining if a borrower can establish a defense to the repayment of a loan based on an act or omission of an institution.

Statutory cite: §455(h) of the Higher Education Act of 1965, as amended

Regulatory cite: 34 CFR 685.206(c)

Summary of issue:

Beginning with the Direct Loan program regulations issued in 1994, and as clarified in a Notice of Interpretation issued in 1995, the current borrower defense (BD) standard requires a Direct Loan borrower to establish the existence of an "act or omission" by the institution attended by the student that would give rise to a cause of action against the school under "applicable State law" to demonstrate a defense to repayment. In its 1995 Notice of Interpretation,[1] the Department clarified that a BD claim would be recognized only if it was directly related to the loan at issue or the educational services for which the loan was provided. The regulation reads, in relevant part:

> *In any proceeding to collect on a Direct Loan, the borrower may assert as a defense against repayment, any act or omission of the school attended by the student that would give rise to a cause of action against the school under applicable State law* [34 CFR 685.206(c)(1)].

Acting Under Secretary James Manning stated to Senator Durbin on July 7, 2017, "No borrower defense applications have been approved between January 20, 2017, and today."

The Department currently evaluates claims under this State law-based standard.

The HEA directs the Secretary to issue regulations in this area. The relevant section of the statute reads, in full:

> *Notwithstanding any other provision of State or Federal law, the Secretary shall specify in regulations which acts or omissions of an institution of higher education a borrower may assert as a defense to repayment of a loan made under this part, except that in no event may a borrower recover from the Secretary, in any action arising from or relating to a loan made under this part, an amount in excess of the amount such borrower has repaid on such loan* [HEA § 455(h), 20 U.S.C. § 1087e(h)].

Questions for consideration by the committee include:

- Whether and how should the Department establish a uniform ("Federal") standard, as opposed to a standard based on applicable State law, for evaluating BD claims?

The Department has also recognized that a third option is to "establish a Federal standard that serves as a floor, or minimum requirement, to provide additional consumer safeguards to borrowers in States that have less robust consumer protection laws." 81 FR 75939.

[1] https://www.gpo.gov/fdsys/pkg/FR-1995-07-21/html/95-17988.htm

In 2016, the Department **rejected fraud as standard:** "We believe that an institution is responsible for the harm to borrowers caused by its misrepresentations, even if such misrepresentations cannot be attributed to institutional intent or knowledge and are the result of inadvertent or innocent mistakes. Similarly, we believe this is the case even for statements that are true, but misleading. We believe this is more reasonable and fair than having the borrower, or the Federal government and taxpayers, bear the cost of such injuries." 81 FR 75947. As the Department explained, "Gathering evidence of intent would likely be nearly impossible for borrowers. Information asymmetry between borrowers and institutions, which are likely in control of the best evidence of intentionality of misrepresentations, would render borrower defense claims implausible for most borrowers." 81 FR 75937.

The Department previously said the definition should correspond, and noted "[a]ligning the definition and types of substantial misrepresentations for borrower defense with the Department's long-held authority to bring enforcement actions under part 668 . . . will provide more clarity for schools and reduce their burden in having to interpret and adjust for the new borrower defense standards." 81 FR 75947.

The Department established a federal standard in final 2016 regulations that would "allow a borrower to assert a borrower defense on the basis of a substantial misrepresentation, a breach of contract, or a favorable, nondefault contested judgment against the school." 81 FR 75926.

In the 2016 rulemaking, the Department stated it was "committed to protecting student loan borrowers from misleading, deceitful, and predatory practices of, and failure to fulfill contractual promises by, institutions participating in the Federal student aid programs." 81 FR 75935.

- If we establish a Federal standard, what should serve as the basis for a BD claim? Should the definition of misrepresentation that governs a borrower's defense to repayment correspond to the definition that governs the Department's own enforcement actions in 34 CFR 668.71?

- Should such a Federal standard be based on common law fraud as its definition? The Restatement (Second) of Torts defines fraudulent misrepresentation as: "One who fraudulently makes a misrepresentation of fact, opinion, intention or law for the purpose of inducing another to act or to refrain from action in reliance upon it, is subject to liability to the other in deceit for pecuniary loss caused to him by his justifiable reliance upon the misrepresentation." Restatement (Second) of Torts § 525 (1977).

- Should this Federal standard require a borrower to demonstrate a reasonable reliance on the act or omission causing injury to the borrower? Are there other definitions or requirements that could be considered?

- What should be the burden of persuasion for a borrower's claim? In fraud cases, a majority of courts apply the clear-and-convincing standard of proof to the elements of a claim for fraud. Restatement (Third) of Torts: Liab. for Econ. Harm § 9 (tentative draft no. 2, 2014). However, for causes of action based on consumer protection law, some states have concluded that only a preponderance of the evidence is required. *See, e.g.*, Malooley v. Alice, 621 N.E.2d 265, 268 (Ill. App. 1993).

- What factors should the Department consider when determining the amount of relief a borrower should receive? Should the Department consider the borrower's actions or circumstances when determining the amount of relief? Should the Department consider whether the borrower could have ascertained the truth without difficulty, inconvenience, or special skill?

The Department also concluded the definition of misrepresentation in § 668.71 should be updated to include "not only false or erroneous statements, but also misleading statements that have the likelihood or tendency to mislead under the circumstances" and to clarify that "omissions of information are also considered misrepresentations." 81 FR 75945.

The Department recognized in 2016 that in certain situations, "a borrower would have reason to believe he or she could rely on the information being given," such as when "the statement was made by an individual whom the borrower believed could be trusted to give accurate information, such as a school admissions officer." 81 FR 75948.

The Department previously concluded that the "preponderance of the evidence" standard "is appropriate" for borrower defense claims, explaining: "it is the typical standard in most civil proceedings. Additionally, the Department uses a preponderance of the evidence standard in other proceedings regarding borrower debt issues." It noted: "We believe that this evidentiary standard strikes a balance between ensuring that borrowers who have been harmed are not subject to an overly burdensome evidentiary standard and protecting the Federal government, taxpayers, and institutions from unsubstantiated claims." 81 FR 75936.

The Department recognized in 2016 that "reasonableness" of reliance depends on the borrower's circumstances and the context of the interaction, explaining "it is appropriate" to "consider the totality of circumstances in which the statement or omission occurs, including the specific group at which a statement . . . was targeted, to determine whether the statement or omission was misleading under the circumstances." 81 FR 39342. "We also recognize that school conduct that takes advantage of the borrower's distress or lack of knowledge or sophistication may also . . . affect[] a borrower's reasonable reliance on a misrepresentation." 81 FR 39343. The Department also found that when an institution has made a substantial misrepresentation to a group of borrowers, such as advertising false job placement rates, there should be a "rebuttable presumption" of "reasonable reliance" by those borrowers, noting a similar presumption "exists under Federal consumer law." 81 FR 75971.

The Department previously stated that "the starting point for any relief determination is the full amount of the borrower's costs incurred to attend the institution" and that "the presence of some modest value does not mean full relief is inappropriate." 81 FR 75957.
The 2016 regulations placed the burden of proof on the school to prove any value of education when the Department seeks relief from the school for a group of students based on widespread school misconduct. 81 FR 76086.

Issue Paper 2
Session 1: November 13 – 15, 2017

Issue: Developing a regulatory framework for the process of submitting and evaluating a borrower defense to repayment (BD) claim

Statutory cites: §455(h) of the Higher Education Act of 1965, as amended

Regulatory cites: 34 CFR 685.206(c)

Summary of issue:

Regulations currently in effect do not describe the process for a borrower to submit and the Department to evaluate a BD claim. An ideal BD claim process should be easily understood, facilitate the submission of sufficient evidence to adjudicate the claim, establish clear expectations for the borrower and the school regarding next steps and timeframes, and assure claims are addressed fairly and equitably for both the borrower and the institution.

Questions for consideration by the committee include:

- What process should a borrower follow to submit and establish a basis for a BD claim?
- Should a borrower be granted an automatic administrative forbearance and should collection actions be stopped while his or her BD claim is being processed?
- What evidence should the borrower be required to provide to support a BD claim?
- What due process and notification requirements should the Department provide to an institution of a pending BD claim? What opportunity should be provided for the school to respond to a borrower's BD claim?
- Should the process differ depending on whether the school is open or closed?
- Should the process provide an opportunity for borrowers with other Federal loans to consolidate those loans into the Direct Loan (DL) program to allow the borrower to raise a defense to repayment of those loans under the DL regulation?

On June 14, 2017, Sec. DeVos postponed the effective date of borrower defense regulations finalized November 1, 2016. She stated in the press release that the borrower defense process in that regulation is "a muddled process that's unfair to students and schools, and puts taxpayers on the hook for significant costs." The issues identified in this Issue Paper were discussed extensively in the 2016 rulemaking. Where exactly did that process go wrong, in the Department's view?

The Department's 2016 rule explained "the individual borrower defense process . . . is intended to be a simple process that a borrower may access without the aid of counsel." 81 FR 75928.

In 2016, the Department's view was that automatic administrative forbearance "will reduce the potential burden on borrowers pursuing borrower defenses. These borrowers will be able to focus on supplying the information needed to process their borrower defense claims without the pressure of continuing to make payments on loans for which they are currently seeking relief." 81 FR 76050-51.

The 2016 final regulations also provided for the Secretary to "allow a claim to proceed without receiving an application" from an individual." 81 FR at 75928. The Department has used this authority in the past to grant automatic group borrower discharge.

The Department previously stated that "wherever possible" it "will rely on evidence established by appropriate authorities" to consider whether "whole groups of students are eligible for borrower defense relief." https://www.ed.gov/news/press-releases/fact-sheet-protecting-students-abusive-career-colleges. The 2016 rules allow evidence to "come from submissions to the Department by claimants, State AGs or other officials, or advocates for claimants, as well as from the Department's investigations." 81 FR 75940.

The Department previously recognized that to "even the playing field for students," who generally don't have access to lawyers, the process should not pit schools against students: "Individual claims will be decided in a nonadversarial process managed by a Department official, and group claims would be brought by the Department against the school, not by students. Thus, the process does not require students to directly oppose schools." 81 FR 75962.

The Department previously committed to providing "an effective process for all borrowers", including FFEL borrowers, to access borrower defense relief. 81 FR 75961

In 2016, the Department's view was that "institutions that are providing clear, complete, and accurate information to prospective and enrolled students are **exceedingly unlikely** to generate successful borrower defense claims." 81 FR 75957

The Department previously stated that "a significant share" of the cost of borrower defense "**will be offset** by the recovery of funds from institutions whose conduct gave rise to the claims." 81 FR 75927

Issue Paper 3

Session 1: November 13-15, 2017

Issue: Financial Responsibility and Administrative Capability

Statutory cites: §§487(a) and (c), and 498, of the Higher Education Act of 1965, as amended

Regulatory cites: 34 CFR 668.14, 668.16, 668.43, and part 668 subpart L

Summary of issue:

Under the HEA, the Secretary establishes standards for financial responsibility and administrative capability that institutions must meet to participate in the Federal student financial aid programs authorized under title IV. If an institution violates these requirements, the Secretary may limit, suspend, terminate, or otherwise condition the institution's title IV participation.

Under the Department's current regulations at 34 CFR 685.206(c), borrower defense discharges are granted in instances where it is determined that an institution has committed a violation of applicable State law. When the Department discharges a borrower's loans, the taxpayer assumes the costs of that discharge. This raises the question of to what extent the institution is liable for the costs to the Department/taxpayer of those violations and the resulting discharges. However, allegations of institutional misconduct may increase the likelihood that an institution will close, not have sufficient resources to pay outstanding or forthcoming borrower defense claims, or both. Therefore, if the Department decides to promulgate regulations requiring institutions to bear financial responsibility for borrower defense claims, it may also be necessary to require that institutions post sureties in some instances to ensure that the taxpayers are not solely responsible for borrower defense loan discharges stemming from the institution's unlawful acts.

Questions for consideration by the committee:

- Under what conditions or to what extent should institutions incur liability for reimbursement of borrower defense claims?
- Should the Department require the posting of sureties by institutions that are determined to be at risk for closure and/or borrower defense claims? Which metrics should be used when making these determinations?
- Should the Department take additional steps to protect taxpayer interests?

Both the Department's 1995 and 2016 borrower defense rules provide for the Secretary to initiate proceedings against an institution to recover losses owing to successful borrower defense claims. 60 FR 37770; 81 FR 75929.

The Department stated in 2016 that applicable law gives the Department the right to recover **the full amount** from the school losses incurred on Direct Loans. 81 FR 75930. It also stated that under current regulations, there is **no limit on the time** in which the Department could take recovery action if the institution received notice of a claim within the three-year period. 81 FR 75955.

In 2016, the Department included financial responsibility requirements in order to provide "**far stronger incentives** for schools to avoid committing acts or making omissions that could lead to a valid borrower defense claim." 81 FR 76050

The Department previously explained: "Recent experiences with **Corinthian**, in which the Department ended up with no financial protection for either closed school or borrower defense claims," convinced it that sureties are necessary, and that "the routine tests under current regulations **did not result in financial protection**, because Corinthian appeared at the time…to pass those tests." 81 FR 39361

In 2016, the Department observed that it "has, since at least the 1994 regulations, consistently considered" that "a **single significant occurrence**" could be "sufficient grounds to render an institution not financially responsible." 81 FR 75980. The Department also found it necessary to apply certain financial protection triggers to **proprietary institutions** because of "the **fundamental differences in the governance structures** and missions of the public and nonprofit sectors and the unique nature of the business model under which these institutions operate." 81 FR 75934

The Department recognized in 2016 that "only a small percentage of non-profit institutions currently use arbitration agreements with their students." 81 FR 76016. On the other hand, "some institutions, notably Corinthian, aggressively used class action waivers to thwart actions by students for the very same abusive conduct that government agencies, including this Department, eventually pursued. Corinthian used these waivers to avoid the publicity that might have triggered more timely enforcement agency action, which came too late[.]" 81 FR 76022.

"Nearly all of the negotiators supported" limitation on class action waivers and predispute arbitration in 2016. 81 FR 39381

The Department considered comments from arbitration defenders, and found "nothing in th[ose] comments . . . demonstrates that these [negative] effects [of predispute arbitration and class action waiver] are exaggerated or mischaracterized, that the disadvantages and burdens the regulation would place on schools outweigh the costs and harm that use of class action waivers has already caused, or that there is any reason to expect that this pattern will change so that such waivers will not cause these same problems in the future." 81 FR 76026

Issue Paper 4
Session 1: November 13-15, 2017

Issue: Pre-dispute Arbitration Agreements, Class Action Waivers, and Internal Dispute Processes

Statutory cites: §§454(a)(6) and 455(h), of the Higher Education Act of 1965, as amended

Regulatory cites: 34 CFR 685.300(b)(11), (d)-(i) [*2016 regulatory package*]

Summary of Issue:

Some institutions require students to sign an enrollment agreement prior to matriculation that requires a student to pursue arbitration or the internal resolution of claims made against the institution before the student may submit complaints to outside entities or litigate the claim in court. Such institutions may also include provisions by which students waive their right to be a part of, or to initiate, a class action lawsuit. Critics of arbitration agreements have argued that arbitration can be a secretive process that lets companies dictate the terms of negotiations. Defenders have argued that arbitration agreements can lower the cost of delivering education by avoiding costly litigation and that arbitration is an efficient way to resolve disputes.

In 2016, such critics included the Department. It found that predispute arbitration agreements and class action waivers "jeopardize the taxpayer investment" in student loans, because those devices "insulat[e institutions] from direct and effective accountability for their misconduct," "deter publicity that would prompt government oversight agencies to react," and "shift the risk of loss for that misconduct to the taxpayer." 81 FR 75926, 76022.

At the same time, prohibitions on pre-dispute arbitration agreements and class action waivers have been held to violate the Federal Arbitration Act (FAA). The FAA "establishes a liberal federal policy favoring arbitration agreements" that applies "unless the FAA's mandate has been overridden by a contrary congressional command." *CompuCredit Corp. v. Greenwood*, 565 U.S. 95, 97-98 (2012). This policy protects the right of parties to set dispute resolution procedures by contract.

The Department of Justice recently took the position in litigation over the National Labor Relations Act (NLRA) that administrative interpretation of another federal statute cannot supersede the FAA policy in favor of arbitration. Brief for the United States as Amicus Curiae Supporting Petitioners in Nos. 16-285 and 16-300 and Supporting Respondents in No. 16-307, *Epic Systems Corp. v. Lewis*, No. 16-285 (U.S. June 16, 2017), 2017 WL 2665007. The Department of Justice stated that because the NLRA contains no express congressional command overriding the FAA's policy favoring arbitration agreements, the National Labor Relations Board cannot read the NLRA to trump the FAA policy in favor of arbitration—even though an agency's interpretation of its own statute normally receives deference. *Id.* at 18-25.

The Supreme Court has also held that a prohibition on class arbitration waivers in consumer contracts violates the federal policy favoring arbitration agreements. The Court explained that a state-law rule disapproving of class arbitration waivers conflicts with the FAA because the imposition of class procedures undermines the advantages of arbitration, including increased efficiency, decreased cost, and reduced risk to defendants. *AT&T Mobility LLC v. Concepcion*, 563 U.S. 333, 347-51 (2011).

In addition, Congress recently passed, and the President signed, a resolution that nullified rules issued by the Consumer Financial Protection Bureau (CFPB) that would have prohibited the use of class action waivers in contracts for consumer financial products and services that provide for the arbitration of future disputes.

The Higher Education Act (HEA) does not address arbitration agreements or class action waivers. However, the final 2016 regulations promulgated pursuant to the HEA prohibit a school participating in

The Department considered these same authorities in 2016 and concluded that the imposition of conditions on participation in Title IV programs did not "override, displace, or disregard the FAA." See 81 Fed. Reg. 81 Fed. Reg. 75926, 76021-24. Rather, "these regulations impose a condition on the participation by a school in this specific Federal program, a Federal program in which Congress explicitly stated that``no institution shall have a right to participate . . ." 20 U.S.C. 1087b(b). " 81 FR 76023. "An institution that chooses not to continue to participate" in Title IV programs "remains free to rely on" predispute arbitration provisions. 81 FR 76025

The Department "expect[ed] that the potential exposure to class actions w[ould] motivate institutions to provide value and treat their student consumers fairly in order to reduce the likelihood of suits in the first place." 81 FR 76026.

the Direct Loan Program from (1) requiring arbitration to resolve claims brought by a borrower against the school that could also form the basis of a borrower defense under the Department's regulations and (2) obtaining or attempting to enforce a waiver of or ban on class action lawsuits for such claims.

The 2016 regulations also prohibit schools from requiring students to use internal complaint processes before seeking remedies from accrediting agencies or government agencies. Some have argued that mandatory internal grievance procedures promote transparency and collaboration between students and institutions that helps to resolve grievances in advance of adversarial—and potentially costly—litigation or arbitration. Others have argued that if a student believes that the grievance is significant enough to warrant the attention of accreditors or government authorities, the complaint should be brought to their attention right away.

"The [2016] regulations do not discourage the use and promotion of internal grievance procedures, and we encourage schools to adopt those procedures in order to remedy grievances before they become claims that lead to litigation or arbitration." 81 FR 76031. They prevent schools from requiring students to exhaust an internal complaint procedure before raising borrower defense claims.

Questions for consideration by the committee include:

"Others" includes the Department, as this was the Department's position in 2016: "if the student believes that the grievance is significant enough to warrant the attention of law enforcement officials or bodies empowered to evaluate academic matters, we believe that the benefit of bringing that complaint to their attention outweighs the benefits of attempting to compel the student to delay." 81 FR 76031.

- Apart from an outright prohibition on the use of pre-dispute arbitration agreements and class action waivers, are there other measures in this area that the Department could take to promote the interests of borrowers?
- Should the Department regulate schools' internal dispute resolution processes?

In 2016, the Department concluded that "nothing in the comments opposing the regulation demonstrates that . . . the substantial problems created by the use of class action waivers can be reduced or eliminated by more modest measures." 81 FR 76026.

The Department's view in 2016 was that "it is not always in the individual borrower's best interest to continue a program through graduation. In a closed school situation, the value of the degree the borrower obtains may be degraded, depending on the reasons for the school closure. Borrowers at closing schools may incur unmanageable amounts of debt in exchange for relatively low-value degrees. We do not believe that it is **good public policy** to require these borrowers to repay that debt if they cannot or choose not to complete the program and are eligible for a closed school discharge." 81 FR 76034

Issue Paper 5

Session 1: November 13-15, 2017

Issue: Closed School Discharge

Statutory cites: §437(c) of the Higher Education Act of 1965, as amended

Regulatory cites: 34 CFR 674.33(g), 682.402(d), and 685.214

Summary of issue:

Current regulations generally require a borrower to submit a written request for a closed school discharge. That request generally must be in the form of a sworn statement that states the borrower (or student on whose behalf a parent borrowed):

1. Received the proceeds of a loan, in whole or in part, to attend an eligible institution;
2. Did not complete the program of study at that institution because it closed while the student was enrolled or the student withdrew from the school not more than 120 days before the school closed; and
3. Did not complete the program of study through a teach-out at another school or by transferring academic credits or hours earned at the closed school to another school.

However, the regulations also give the Secretary the authority to discharge a loan without an application from the borrower. Under 34 CFR 685.214(c)(2), "[t]he Secretary may discharge a [Direct Loan] under this section without an application from the borrower if the Secretary determines, based on information in the Secretary's possession, that the borrower qualifies for the discharge." Similar provisions exist for Federal Family Education Loan (FFEL) program loans and Perkins loans.

Pre-2016 regulations allow for the Secretary to grant a closed school discharge without the borrower providing any documentation to the Secretary. 81 FR 76038.

Question for consideration by the committee:

- Should the Department extend the eligibility period for seeking a closed school discharge to a period other than the current 120 days before the school closed?
- What documentation, when necessary in support of a sworn statement, must the borrower provide to demonstrate to the Secretary's satisfaction that a borrower is eligible for a closed school discharge?
- Should the Department expand upon the Secretary's existing authority to issue a closed school discharge without an application? What information must the Secretary possess before making a determination to permit a discharge without an application?

The 2016 rules provided for automatic closed school discharges, stating that the Department would "discharge the loan without an application from the borrower if the borrower did not subsequently re-enroll in any title IV-eligible institution within a period of three years from the date the school closed." 81 FR 76081. The automatic closed school discharge provisions were meant to be implemented "as soon as operationally possible." 81 75928.The Department explained it was "concerned that borrowers are unaware of their possible eligibility for a closed school discharge" and thus "[m]any borrowers eligible for a closed school discharge do not apply." 81 FR 39369. It noted "for the period between 2011 and 2015 there were 43,268 students attending closed schools, of which 9,606 students received a closed school discharge." 81 FR 76065.

Issue Paper 6
Session 1: November 13 - 15, 2017

Issue: False Certification

Statutory cites: §437(c) of the Higher Education Act of 1965, as amended (HEA)
Regulatory cites: 34 CFR 685.215

Summary of issue:

The HEA provides that if a student's eligibility to borrow "was falsely certified by the eligible institution or was falsely certified as a result of a crime of identity theft . . . then the Secretary shall discharge the borrower's liability on the loan (including interest and collection fees)." Section 437(c) of the HEA, 20 U.S.C. § 1087(c)(1). The corresponding Direct Loan Program regulation states that a borrower's loans are discharged when "a school falsely certifies the eligibility of the borrower (or the student on whose behalf a parent borrowed) to receive the loan." 34 CFR 685.215(a)(1).

A student's eligibility to borrow has been falsely certified by the school if the school:

- Certified the student's eligibility for the loan on the basis of the borrower's ability to benefit from the institution's training and the student did not meet the eligibility requirements;
- Signed the borrower's name on the loan application or promissory note without the borrower's authorization;
- Certified the eligibility of a student who, because of a physical or mental condition, age, criminal record, or other reason accepted by the Secretary, would not meet the requirements for employment (in the student's State of residence when the loan was originated) in the occupation for which the training program supported by the loan was intended;
- Certified the borrower's eligibility for a Direct Loan as a result of the crime of identity theft committed against the borrower; or
- Without the borrower's authorization, endorsed the borrower's loan check or signed the borrower's authorization for electronic transfer, unless the proceeds of the loan were delivered to the student or applied to charges owed by the student to the school.

The Secretary also has the discretion to discharge a loan for false certification "without an application from the borrower if the Secretary determines, based on information in the Secretary's possession, that the borrower qualifies for a discharge" 34 CFR 685.215(c)(7).

Question for consideration by the committee:

- Should the false certification regulation be changed to include other circumstances under which a borrower's student loan would be considered to have been falsely certified?

The Department determined in 2016 that the false certification regulation should be changed "specifically to address the problem of schools encouraging non-high school graduates to obtain false high school diplomas to qualify for Direct Loans." 81 FR 39377.It further explained that "because there is no longer a statutory basis for certifying the eligibility of non-high school graduates based on an `'ability to benefit'," the rule should be updated to "state more explicitly that a school's certification of eligibility for a borrower who is not a high school graduate, and does not meet the alternative to high school graduate requirements, is grounds for a false certification discharge." 81 FR 39377.The Department also determined that the regulation should be changed to provide for false certification discharges where the "Department has information in its possession showing that the school has falsified the Satisfactory Academic Progress (SAP) of its students." 81 FR 39377.

"The Department has consistently taken the position that costs may only be assessed on a borrower if she does not enter into a repayment agreement - of which a rehabilitation agreement is simply one form - in a timely manner and comply fully with the agreement, because failure to timely agree to voluntarily repay requires the guarantor to incur these collection costs." Amicus Brief of the Dep't of Educ., Bible v. USAF at p.14. Similarly, in a 2002 filing, the Department stated: "The regulations [34 C.F.R. § 682.410(b)(5)] . . . direct guarantors to charge collection costs only to those debtors who cause the guarantor to incur collection costs by failing to agree promptly to repay voluntarily. The Department follows the same procedure when it takes assignment of defaulted loans from guarantors." Brief of Secretary of Educ. , Educ. Credit Mgmt. Corp. v. Barnes, 318 B.R. 482 (S.D. Ind. 2004), at p.22 (filed Mar. 14, 2002). Thus, the regulations "ensure that charges are imposed only on those debtors who fail to cooperate and thereby cause the guarantor to incur collections costs." Id. at 23

Issue Paper 7
Session 1: November 13-15, 2017

Issue: Guaranty Agency Collection Fees

Statutory cites: §§428F(a) and 484A(a) of the Higher Education Act of 1965, as amended

Regulatory cites: 34 CFR 682.405(b)(1)(vi)(B)

Summary of issue:

In the Federal Family Education Loan (FFEL) Program, a guaranty agency, after it pays a default claim and acquires the loan from the lender, is required to send an initial notice to the borrower. In that notice, the guaranty agency must give the borrower at least 60 days to take any of several actions, including entering into a repayment agreement with the guaranty agency. The Department, for loans it holds, does not charge collection costs to a defaulted borrower who enters into a repayment agreement or loan rehabilitation agreement within the 60-day period following an initial notice to the borrower.

In 2015, the Department was asked whether, under Federal law, guaranty agencies could charge collection costs to defaulted borrowers who promptly enter into a repayment agreement, including a loan rehabilitation agreement, and who honor that agreement. In Dear Colleague Letter (DCL) GEN-15-14 (July 10, 2015), we addressed this issue and explained that the Department's regulations bar a guaranty agency from charging collection costs to a defaulted borrower who enters into a repayment agreement (including a rehabilitation agreement) within 60 days of receiving the initial notice sent by the guaranty agency after the guaranty agency acquires the loan from the lender and who honors that agreement. The Department withdrew that DCL in March 2017 due to the lack of notice and opportunity to comment and said that it would pursue rulemaking on this issue.

Question for consideration by the committee:

- Should the Department revise 34 CFR 682.410(b), regarding the charging of collection costs by a guaranty agency to a defaulted borrower who responds within 60 days to the initial notice sent by the guaranty agency after it pays a default claim and acquires the loan from the lender?

This revision would be consistent with the Department's interpretation of the regulation. As the Department explained in a 1997 letter to a guaranty agency, § 682.410(b)(5)(ii)(D) "provides the borrower an opportunity to enter into a satisfactory repayment agreement before the agency either reports the default to a credit bureau or assesses collection costs against a borrower as required in §682.410(b)(2)." Letter from Ronald E. Streets, Program Specialist, Policy Dev. Div., Student Financial Assistance Programs, U.S. Dep't of Educ., to Phillip Cervin, Ass't Vice President, Collections, Texas Guaranteed Student Loan Corp. (July 28, 1997) ("Streets Letter."). (cited in Amicus Brief of the Dep't of Educ., Bible v. USAF, at p.13-14).

Issue Paper 8
Session 1: November 13-15, 2017

Issue: Whether to recalculate a borrower's Subsidized Usage Period and interest accrual, if applicable, when the borrower receives a discharge of a loan for which he or she has not received all or part of the educational benefit of the loan

Statutory cite: § 455(q) of the Higher Education Act of 1965, as amended (HEA)

Regulatory cite: 34 CFR 685.200(f)

Summary of issue:

Section 455(q) of the HEA provides that a first-time borrower on or after July 1, 2013, is not eligible for additional Direct Subsidized Loans if the borrower has received Direct Subsidized Loans for a period that is equal to or greater than 150 percent of the length of the borrower's current program of study. In addition, some borrowers who are not eligible for Direct Subsidized Loans because of the 150 percent limit become responsible for the interest that accrues on their loans when it would otherwise be paid by the government. Neither the statute nor regulations issued prior to the delayed 2016 regulations address what effect a discharge of a Direct Subsidized Loan has on the 150 percent limit. They also do not address whose responsibility it is to pay the outstanding interest on any remaining loans that have not been discharged, but have previously lost eligibility for interest subsidy.

Currently, the Department does not include in the calculation of a borrower's subsidized usage period, the subsidized usage period associated with a Direct Subsidized Loan or the portion of a Direct Consolidation Loan that repaid a Direct Subsidized Loan if the borrower receives a discharge that demonstrates the borrower did not receive all or part of the educational benefit of the loan. The discharges that meet this description are: closed school, false certification, unpaid refund, and borrower defense.

As a part of the November 1, 2016, final regulations, the Department reflected this practice by amending 34 CFR 685.200(f)(4)(iii) to specify that a partial or full discharge based on school closure, false certification, unpaid refund, or borrower defense would result in the elimination or recalculation of the subsidized usage period associated with the loan(s) discharged in calculating a borrower's subsidized usage period. The Department also amended 34 CFR 685.200(f)(3)(v) to provide that if all or part of a Direct Subsidized Loan (or applicable portion of a Direct Consolidation Loan) is discharged such that a borrower has a remaining eligibility period, the Department reinstates the interest subsidy on any eligible loans and refunds applicable amounts already paid by the borrower.

Questions for consideration by the committee include:

- Should the Department recalculate or eliminate the applicable subsidized usage period from calculation of the borrower's subsidized usage period and reinstate interest subsidy (if applicable) when a borrower receives a loan discharge?

- If so, to which discharges should recalculation or elimination of subsidized usage periods apply?