Insight

The Department of Education's Newly Proposed Regulations Increase Eligibility for Student Loan Forgiveness

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Executive Summary

- On July 13, the Department of Education proposed new regulatory changes to five federal targeted student loan forgiveness programs.
- The proposed changes would ease the programs' eligibility requirements and allow the Biden Administration to identify and forgive the loans of more borrowers.
- These changes could allow the Biden Administration to use the Borrower Defense to Repayment program, which focuses on forgiving the debt of students at for-profit colleges, to extend federal student loan forgiveness to large swaths of students at public and private non-profit universities.
- These regulatory changes would allow the Biden Administration to pursue its goal of expanding federal student loan forgiveness through the existing targeted forgiveness mechanisms, without necessarily having to attempt blanket loan forgiveness.

Introduction

On July 13, the Department of Education (ED) proposed new regulatory changes to five federal targeted student loan forgiveness programs. The five programs are:

1. Borrower Defense to Repayment (BDR);
2. Public Service Loan Forgiveness (PSLF);
3. Total and Permanent Disability Discharge (TPD);
4. Closed School Discharge; and
5. False Certification.

ED also proposed changes to interest capitalization on federal student loans. The five programs codify certain standards under which the federal government can cancel students' outstanding federal loan balances.[1] Through these proposals, the Biden Administration is attempting to increase the number of borrowers eligible to qualify for federal student loan forgiveness.

The Borrower Defense to Repayment (BDR) is the largest of the five affected programs. It traditionally has been used to forgive the student debt of those who attended for-profit colleges. If finalized, the Biden Administration could interpret the newly broadened rules regulating BDR to extend federal student loan forgiveness to large swaths of students of non-profit public and private universities.

President Biden campaigned on providing $10,000 in blanket forgiveness for all federal student loan holders but has yet to do so due to uncertainty over whether his administration has the legal authority without congressional action. In the meantime, the administration has used the five aforementioned targeted mechanisms, mainly BDR, to provide as much loan forgiveness as possible, mostly for former students of for-profit colleges. If finalized, the proposed changes could allow the Biden Administration to, in effect, enact blanket loan forgiveness through the existing targeted forgiveness mechanisms.

Based on statutory rules, ED must finalize any proposed rules by November 1 in any given year for the proposed changes to go into effect in July of the following year. Therefore, the earliest these proposed changes could go into effect would be July 1, 2023.

As previous American Action Forum research has shown, blanket federal student loan forgiveness in any amount is regressive policy: Higher-income families would receive the majority of such loan forgiveness as they hold the majority of outstanding student loan debt. Moreover, such policies could wreak havoc on the federal student loan system itself by creating a moral hazard. Future borrowers would be disincentivized from repaying their loans in a timely fashion (as they would likely anticipate their loans being forgiven). If enough students were to hold this perspective, the entire federal loan system could be inundated with poorly underwritten and possibly fraudulent loans. And because taxpayers back federal student loans, forgiveness amounts to providing taxpayer-financed checks to each loan holder, unfair to those who have repaid their loans or have never pursued higher education. Nevertheless, the administration is moving forward with various methods of forgiving student loans. This insight reviews the regulatory changes ED proposed on July 13, 2022.

Proposed Changes to Borrower Defense to Repayment

This section reviews the major changes ED has proposed to BDR.[2]

BDR allows borrowers of federal direct loans to claim to the federal government that they were misled or defrauded by the higher education institution they attended, or if their higher education institution engaged in misconduct in violation of certain state laws. If ED determines these borrower claims have merit according to BDR standards, it will cancel all or a portion of outstanding federal student loan debt for the borrower.

In the newly proposed changes to BDR, the five grounds on which a BDR claim could be made are:[3]

1. Substantial Misrepresentation;
2. Substantial Omission of Fact;
3. Breach of Contract;
4. Aggressive and Deceptive Recruitment; or
5. “A federal or state judgement or departmental adverse action against an institution that could give rise to a borrower defense claim.”

Changes to Substantial Misrepresentation

ED has proposed expanding the first standard of substantial misrepresentation, defined as when a borrower was told misleading or false statements by a higher education institution about its characteristics such as class size, faculty-student ratios, job placement rates, the ability to transfer credits, or the guarantee of a job after graduation. More specifically, ED has proposed to include to this standard “false, erroneous, or misleading statements concerning institutional selectivity rates or rankings as a form of misrepresentation, because it has observed institutions leveraging false data reported to widely recognized national rankings that result in a higher institutional or program rank than they would otherwise have received." ED also has proposed the removal of the requirement that borrowers show a higher education institution purposely made misrepresentations. That would mean misrepresentations, regardless of intent, could be grounds for forgiveness through BDR. The proposed changes would also mean the borrower would not have to show that these misrepresentations caused them financial harm, but rather that they relied on the misrepresentation to take out a federal loan to pay tuition.

New Standards

If finalized, Standard Two, substantial omission of fact, as well as Standard Four, aggressive and deceptive recruitment, would be made new categories. Under current BDR regulations, Standard Two is largely accounted for in Standard One. ED, however, would make it a new standard to provide more "clarity," so that if a university omits information to prospective students, ED can more easily extend forgiveness through BDR, just as it would under Standard One. Aggressive and deceptive recruitment is loosely defined as when a higher education institution presented accurate facts to prospective students yet did so in such an aggressive way as to prevent the borrower from making a "full and informed" choice.

Streamlined Process and Group Claims

ED has proposed a "single standard and streamlined process for relief that would apply to all future and pending claims as of July 1, 2023, in contrast to prior regulations, which varied based upon the disbursement date of the borrower's loans." This means the expanded standards proposed above would be applied to all BDR applications, regardless of when the alleged misconduct took place, provided the application is submitted on or after July 1, 2023. ED has also proposed allowing group claims. This change would allow ED, itself, to initiate BDR applications, even if an individual borrower has not yet submitted a claim. That would mean ED could identify a group of borrowers and forgive their loans without having to judge the hypothetical merits of individual borrowers' claims.

ED has proposed additional changes to further streamline the BDR claim process. The proposed changes are:

- Create a reconsideration process for BDR applications that have been or will be denied to give borrowers another chance to have their applications judged according to the newly proposed standards.
- Forbid schools that want to participate in federal student loans programs from forcing borrowers to sign mandatory pre-dispute arbitration agreements or waivers of class action lawsuits, which prevent students from filing BDR applications.
- Require in certain instances the higher education institution to pay for a BDR application that is approved by ED.

Summary

Under ED's newly proposed standards on which students can base their BDR applications, its expansion of existing standards, and its newly streamlined process and ability to file and adjudicate group claims, BDR could experience substantial expansion under the Biden Administration. BDR has traditionally been targeted toward current and former students of for-profit colleges.[4] While it remains to be seen how broadly ED would interpret this language if finalized, under a broad interpretation, ED could theoretically attempt to use borrower defense for students of non-profit public and private universities, as well. For example, Columbia University, commonly regarded as one of the top Ivy League universities in the United States, has been stripped of its #2 ranking from U.S. News and World Report because the university allegedly submitted false and erroneous data to bolster its score in that ranking.[5] With a broad interpretation, current and former students of Columbia University could receive forgiveness through BDR by claiming they relied on the false ranking of the university under Standard One, substantial misrepresentation. With the proposed streamline process, many students would now be able to cite prior alleged instances of substantial misrepresentation which might not have been sufficient grounds for loan forgiveness through BDR under current/prior regulations. These changes, including the ability to adjudicate group claims, could allow ED to extend federal student loan forgiveness very broadly through BDR. Finally, if these proposed changes were finalized, future administrations would be able to do the same.

Proposed Changes to Public Student Loan Forgiveness

As with BDR, only borrowers of direct federal student loans are eligible to receive forgiveness through PSLF.

PSLF allows the federal government to forgive outstanding federal student loan debt if a borrower:

1. Has been employed by a federal, state, or local government, tribal agency, or nonprofit organization;
2. Works full-time for that agency or organization;
3. Has direct federal loans, or their loans have been consolidated into a direct loan;
4. Is currently enrolled in an income-driven repayment plan; and
5. Makes 120 qualifying monthly payments.

If a borrower believes they meet these standards, they can apply through PSLF to receive forgiveness on their remaining federal student loan debt. In the proposed changes, ED would first expand the definition of a qualifying employer of a prospective borrower entering PSLF. Among the current qualifying employers are those working in emergency management, government, public health, public education, or a 501(c)(3). New proposed definitions include, but are not limited to, “civilian services to the Military,” “public health,” “non-governmental public service,” and “public library services.” ED has also proposed a broader definition of full-time worker. Under current regulations, to be considered a full-time worker under PSLF, the borrower must work at least 30 hours per week at a qualifying employer or be considered a full-time worker by the organization. A borrower may also have multiple jobs that account for a combined average of 30 hours per week, provided those part-time jobs are with qualifying employers. The proposed changes would redefine a full-time worker as:

1. Working in qualifying employment in one or more jobs at least an average of 30 hours per week for the time period certified; or
2. Working at least 30 hours per week throughout a contractual or employment period of at least 8 months in a 12-month period, such as in the situation of elementary and secondary school teachers, in which case the borrower is deemed to have worked full-time; or
3. Working the equivalent of 30 hours per week as determined by multiplying each credit or contact hour taught per week by at least 3.35 in non-tenure track employment at an institution of higher education.

Changes to Qualifying Payments

Standard Five, regarding the making of 120 qualifying payments, holds that a “borrower must make each of the 120 monthly payments within 15 days of the scheduled due date for the full scheduled installment amount for that payment to qualify toward PSLF." ED's proposed change would allow "counting payments that are equal to the full scheduled payment, even if the payment is made in multiple installments or outside the 15-day period in current regulations so long as the loan is not in default." The proposed regulations would also allow a "borrower to make a lump sum or monthly payments equal to or greater than the full scheduled amount made in advance of the borrower's scheduled payment due date may also receive credit toward forgiveness on those additional payment amounts."[6] This regulatory change would mean that a borrower who is scheduled to make a $100 payment every month under their income-driven repayment plan could instead opt to make a lump sum $1,200 payment during that year and receive the credits for making monthly payments. That borrower would therefore be allowed to make late monthly payments, provided the total amount due is paid by the end of the year.

Current regulations do not allow payments made under deferment or forbearance to count toward PSLF credits. The newly proposed regulations would "allow each month in which a borrower is in one of the following deferment or forbearance periods to count as a month of payment for PSLF purposes if the borrower certifies qualifying employment for the period of time covered by the deferment or forbearance." Some of these proposed deferments or forbearances include cancer treatment deferment, economic hardship deferment, and/or AmeriCorps forbearance.

The proposed regulations would also allow for automatic discharge. Under current regulations, even if a borrower qualifies to have their loans canceled under PSLF, they must still go through the application process. The proposed regulations would allow ED to automatically identify borrowers eligible for forgiveness through PSLF, and automatically discharge their loans without requiring an application from the borrower.

Finally, the proposed regulations would create a reconsideration process so that borrowers who have been denied forgiveness under PSLF could have their applications reconsidered.

Proposed Changes to Total and Permanent Disability Discharge

TPD allows for the cancellation of federal student loans if a borrower is totally and permanently disabled. Borrowers of federal direct loans, federal family education loans (FFEL), federal Perkins Loans, and borrowers under a TEACH Grant obligation are eligible to receive forgiveness through TPD.

Under current regulations, a borrower must provide documentation to ED from the Department of Veterans Affairs, the Social Security Administration (SSA), or a physician showing they are totally and permanently disabled. If a borrower receives loan cancellation through TPD, they must not:

1. Have annual employment earnings that exceed 100 percent of the poverty guideline for a family of two;
2. Receive a new TEACH Grant or Title IV loan (federal student loan);
3. Fail to ensure that the full amount of any disbursement of a Title IV loan or TEACH Grant received prior to the discharge date that is made is returned; or
4. Receive a notice from SSA indicating that they are no longer disabled or that the borrower's continuing disability review will no longer be within a five- to seven-year period.

If the borrower fails to meet these criteria, their loans would be reinstated.

As with ED's proposed changes to the other targeted loan programs, it has proposed easing many of the requirements and standards to receive forgiveness under TPD. These proposed changes would allow not only physicians, but also nurse practitioners, physicians' assistants, and licensed psychologists to provide sufficient documentation demonstrating total and permanent disability for applicants. The proposed changes would also increase the types of SSA documentation that may qualify a borrower for TPD, including but not limited to the "SSA Benefit Planning Query, SSA compassionate allowance program, documentation showing a borrower qualifies for SSDI (Social Security Disability Insurance) or SSI (Supplemental Security Income) benefits with a next scheduled disability review within three years, and the borrower's eligibility for disability benefits in the three-year review category has been renewed at least once." By allowing more types of documentation, ED would make it easier for borrowers to apply for TPD.

ED has also proposed eliminating the borrower's responsibilities after receiving a total and permanent disability discharge, specifically Standards One, Three, and Four. ED has proposed keeping Standard Two—that is, if a borrower under TPD were to receive a new loan, their old loans would be reinstated. Removing these standards would make it easier for borrowers to prevent the reinstatement of their loans by reducing the number of requirements with which they must comply. Most important, ED has also proposed eliminating the three-year income monitoring period for borrowers who have received a TPD discharge. Finally, the proposed changes would allow the ED secretary to "grant a TPD discharge without an application if the Secretary obtains the appropriate documentation from the Department of Veterans Affairs or SSA." These changes would ease the eligibility requirements of TPD and reduce the number responsibilities borrowers must fulfill to receive a TPD discharge, and for that loan to not be reinstated. As with the proposed changes to the other programs, TPD would be expanded to allow for more targeted loan forgiveness.

Proposed Changes to Closed-School Discharge

Closed-School Discharge allows ED to forgive federal student loan balances for students whose schools closed while they were enrolled or shortly after their withdrawal. Borrowers of federal direct loans, FFELs, and Perkin's Loans are eligible to receive forgiveness through Closed-School Discharge.

More specifically, a borrower may be eligible for discharge if they could not earn their degree because their school closed, as well as if:

1. The borrower was enrolled when the school closed;
2. The borrower was on an approved leave of absence when the school closed;
3. The school closed within 120 days after withdrawal, or if their loans were first disbursed before July 1, 2020; or
4. The school closed within 180 days after withdrawal if their loans were first disbursed on or after July 1, 2020.

The proposed changes to Closed-School Discharge focus on expanding timeframes and removing certain limitations. Specifically, ED has proposed to "extend the time period that a borrower has to submit a closed school discharge application before the forbearance period expires to within 90 days of the Secretary or other loan holder providing the discharge application to the borrower." ED has also proposed removing the current requirement that a borrower may only qualify for a Closed-School Discharge without an application if the borrower does not re-enroll in an eligible Title IV school within three years of the school's closure date. Instead, ED would automatically discharge loans for a borrower within one year of the school's closure date unless the borrower accepts and completes an approved teach-out agreement. These changes would give borrowers more time to request Closed-School Discharges, and give ED more power to automatically forgive loans through the program without borrower-submitted applications.

Proposed Changes to False Certification

Through False Certification Discharge, ED can forgive the outstanding federal student loan balances of borrowers whose school falsely determined they were eligible to receive federal student loans. Borrowers of federal direct loans, FFELs, and Perkin's Loans are eligible to receive forgiveness through False Certification Discharge.

The three categories of false certification are:

1. Ability to Benefit: "The school falsely certified your eligibility to receive the loan based on your ability to benefit from its training, and you didn't meet the ability-to-benefit student eligibility requirements that were in effect at the time the school determined your eligibility";
2. Disqualifying Status: "The school certified your eligibility to receive the loan, but at the time of the certification, you had a status (physical or mental condition, age, criminal record, or other circumstance) that disqualified you from meeting the legal requirements for employment in your state of residence in the occupation for which the program of study was preparing you"; and
3. Unauthorized Signature or Unauthorized Payment: "The school signed your name on the loan application or promissory note without your authorization or the school endorsed your loan check or signed your authorization for electronic funds transfer without your knowledge, and the loan money wasn't given to you or applied to charges you owed to the school."

Under the proposed changes, ED would use the borrower's status of having a high school diploma or equivalent at the time of origination of the federal loan, instead of, as under current regulations, the borrower's status at the time of disbursement of the loan. Because origination of loans occurs before disbursement, this proposed change effectively increases the time period during which a borrower could have been falsely certified in the eyes of this program, therefore making it easier for prospective federal loan student holders to receive forgiveness. The proposed changes would also create a group-claim mechanism like that of BDR and Closed-School Discharge. Through the group-claim mechanism, ED would have more flexibility to forgive debt through False Certification Discharge without judging the individual merits of each borrower in that group.

Proposed Changes to Interest Capitalization

ED has also proposed changes to interest capitalization, which occurs when unpaid interest is added to the principal amount of an outstanding federal student loan. Specifically, when a borrower does not pay interest that is due on a loan, the lender, rather than waiting for that interest to be paid, will add that outstanding interest to the outstanding principal of the loan. Interest is then charged on that higher principal overall, meaning the cost of the loan overall has increased.

Under the Higher Education Act (HEA), ED *may* capitalize interest under certain circumstances, such as when:

- A loan enters repayment;
- The grace period of a loan ends;
- The deferment or forbearance period of a loan ends; or
- A borrower defaults on a loan.

HEA *requires* interest capitalization when:

- The deferment period for direct unsubsidized loans, direct PLUS loans, and direct unsubsidized consolidation loans ends; or
- A borrower who is repaying under the income-based repayment plan stops repaying under that plan or is determined to no longer have a partial financial hardship.

Since the proposed changes are of a regulatory nature, they cannot modify the situations where interest capitalization is required by law—in this case, by HEA. The proposed changes, however, can modify the circumstances under which interest capitalization is not required by HEA, but through prior regulations. Hence, the changes ED proposed to end interest capitalization when it is not required by law mostly pertain to the four bullets concerning when ED *may* capitalize interest. These changes can be summarized as:

1. "For a direct unsubsidized loan, a direct unsubsidized consolidation loan that qualifies for a grace period under the regulations that were in effect for consolidation application received before July 1, 2006, a direct PLUS loan, or for a direct subsidized loan for which the first disbursement is made on or after July 1, 2012 and before July 1, 2014, the Secretary may capitalize the unpaid interest accrues on the loan when the borrower enters repayment."
2. Allow ED to capitalize interest that accrues on direct loans during periods of forbearance.
3. "Provides that, subject to some exceptions, the Secretary annually capitalizes unpaid interest when a borrower is paying under the alternative repayment plan or the income-contingent repayment plan described in 685.209(b) and the borrower's scheduled payments do not cover the interest that has accrued on the loan."
4. "States that the Secretary may capitalize unpaid interest when a borrower defaults on a loan."

Of the proposed changes, the most significant of note is the second. If that change were to be finalized, borrowers of federal direct loans (which make up most federal student loans) that entered forbearance would never see their outstanding balances increase due to capitalization. Overall, however, unlike the changes to the targeted forgiveness programs, these do not increase eligibility for borrowers to receive forgiveness. Rather, these changes on interest capitalization are an attempt to reduce the rate at which outstanding balances can grow due to borrowers not paying interest for various reasons, such as when entering forbearance due to economic hardship.

Going Forward

According to the negotiated rulemaking process, since these proposed changes were officially announced in the Federal Register on July 13, the public has 30 days (until August 12) to submit comments on the proposals. ED would then be required to review the submitted comments and incorporate any changes for an eventual final rule to be published. Due to statutory rules, ED must publish the final rule by November 1, 2022, for the rules to go into effect by July 1, 2023.

It remains to be seen exactly what the final rule will look like. If these proposed rules are enacted in their current form, they would indeed lower the eligibility requirements of the five targeted student loan forgiveness programs, as well as streamline their administrative processes. The most major changes are those to the BDR program. It seems feasible that ED could broadly interpret the proposed changes and extend federal loan forgiveness to large swaths of students at public and private non-profit four-year universities, thereby enacting blanket loan forgiveness through targeted programs.

[1] The programs differ from exactly which types of federal student loans are eligible for debt cancellation/forgiveness. Each section of this paper specifies at the beginning which federal loan programs are indeed eligible to receive forgiveness through the corresponding targeted forgiveness mechanism.

[2] It does not include Federal Family Education Loans (FFEL), nor does it include Perkins Loans.

[3] https://www.federalregister.gov/documents/2022/07/13/2022-14631/student-assistance-general-provisions-federal-perkins-loan-program-federal-family-education-loan

[4] https://www.federalregister.gov/documents/2022/07/13/2022-14631/student-assistance-general-provisions-federal-perkins-loan-program-federal-family-education-loan

[5] https://www.chronicle.com/article/after-a-professors-scrutiny-u-s-news-pulls-columbia-universitys-no-2-ranking

[6] https://www.federalregister.gov/documents/2022/07/13/2022-14631/student-assistance-general-provisions-federal-perkins-loan-program-federal-family-education-loan