Insight

Understanding “Borrower Defense to Repayment”: A New Yellow Brick Road to Federal Student Loan Forgiveness

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After more than a year of negotiated rulemaking, the Department of Education (ED) has finalized new regulations pertaining to the Federal Direct Loan Program that establishes a new standard and process for the use of ‘borrower defense to repayment’ (BDTR). These rules were finalized in the aftermath of the Corinthian Colleges and ITT Technical Institutes closures that have reportedly cost federal taxpayers nearly $250 million[1] in debt forgiveness in just four short months. The laws governing federal student aid[2] allow for a discharge of any federal Direct Loans taken out to attend an institution of higher education (IHE), if that IHE is found to have defrauded students related to the loans or the educational services paid for.

Broadening BDTR Standards

The prior rules governing the BDTR program established a standard that allowed borrowers to assert a BDTR if the cause of action arose due to intentional fraud or the violation of applicable State law. In contrast, the new regulations significantly broaden the standard to allow a borrower to assert BDTR based on a substantial misrepresentation, a breach of contract by an IHE, or a contested judgment against an IHE. Moreover, the rule expands the definition of a misrepresentation “to include omissions of information and statements with a likelihood or tendency to mislead under the circumstances.” This definition is also applied to “misrepresentations for which the Secretary may impose a fine, or limit, suspend, or terminate an institution’s participation in title IV, Higher Education Act programs.”[3]

These vague new standards are expected to greatly expand the number of claims filed seeking loan forgiveness as borrowers will now merely need to allege an IHE made a “substantial misrepresentation.”

Broadening Borrower’s Rights

Included in the new rule are borrower protection provisions that prohibit IHE’s from requiring borrowers participate in arbitration agreements to resolve claims brought by a borrower against the IHE, as well as prohibitions that previously prevented borrowers from participating in class action lawsuits to resolve claims. ED has also imposed public notification and disclosure requirements on IHEs regarding claims that are the subject of a lawsuit or voluntary arbitration after a claim has been made, so that students are aware of any impending legal actions before they make any final post-secondary enrollment decisions.

ED has also overtly targeted for-profit schools by requiring **only** those institutions to include loan repayment rates in their marketing materials. This despite the cohort default rate for 2-year public institutions being higher than the national average and only slightly less than the average for proprietary schools, yet these schools are exempt from such marketing requirements.[4]

IHE Financial Responsibility Protections

This rule allows ED to hold participating IHEs financially accountable through the establishment of a financial protection standard meant to help protect students, the Federal government, and taxpayers against potential institutional liabilities by requiring IHEs to provide ED a letter of credit (a letter from an IHE guaranteeing the availability of funding should borrowers win claims for which an institution is liable). The circumstances that would require IHE's to produce a letter of credit include a government entity (attorney general, the Consumer Financial Protection Bureau (CFPB), or the Federal Trade Commission (FTC)) suing the IHE for borrower defense related reasons, debts and liabilities stemming from borrower defense-related administrative actions, or any other lawsuit against the IHE that reaches summary judgment. Other triggers not tied to the legal action against the IHE but indicate risk of closure include the IHE failing the 90/10 non-Federal revenue requirement, the IHE's cohort default rate exceeding 30 percent for two consecutive years, or a program failing to meet gainful employment (GE) requirements.

For each of these triggering offenses, ED can now require the IHE to provide proof that the institution has funding, totaling 10 percent of the total amount of Title IV funds received, available to mitigate losses. Moreover, and potentially devastating to any number of IHE's, ED can require the 10 percent availability of funds for each triggering event, so some institutions could be required to set aside as much as 50 percent of their expected funding received from federal sources.

The likelihood that this rule will bankrupt smaller IHE with limited endowments was well documented by for-profit schools, community colleges and historically black colleges and universities during the comment period and ED chose not to address them during the rule making process. As a result, the rule may prevent thousands of students from accessing a post-secondary or career education.

The Cost of Expanding BDTR

As cited above, the Borrowers Defense Unit of the Office of Federal Student Aid has already reported $250 million in debt forgiveness since June of 2016 – prior to this rule taking effect. Calculating the total cost of the new BDTR rule has been subject to much debate. The Office of Management and Budget originally estimated a cost of $42.6 billion per loan cohort, but has since revised the number to $16 billion. Unfortunately, over the course of the rulemaking, it has become evident that OMB's ability to estimate the cost of the regulation is uncertain at best. This has led to several watchdog groups calling on OIRA to place a hold on the rule until a proper economic analysis can be provided.[5]

Conclusion

Contrary to the administration's stated objective, the new regulation only provides vague standards that vastly expand the grounds upon which a student borrower can sue for federal loan forgiveness. Moreover, the OMB has failed to provide a precise economic impact analysis so that policymakers can properly evaluate the proposal. In short, the new Borrowers Defense to Repayment regulation will likely cost taxpayers a small fortune by paving a new yellow brick road to federal student loan forgiveness.

[1] U.S. Department of Education, Federal Student Aid Enforcement Office, "*Report on Borrower Defense*", October 28, 2016. http://www2.ed.gov/documents/press-releases/borrower-defense-report.pdf

[2] Section 455(h) of the Higher Education Act of 1965 as amended.

> BORROWER DEFENSES.—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.

[3] U.S. Department of Education, Unofficial Final Regulations.

Note: The official version of this document is the document published in the Federal Register.

This document will be published in the Federal Register on November 1, 2016.

http://www2.ed.gov/policy/highered/reg/hearulemaking/2016/bd-unofficialfinalregs-102716.pdf

[4]U.S. Department of Education, Office of Federal Student Aid, Official Cohort Default Rates for Schools. http://www2.ed.gov/offices/OSFAP/defaultmanagement/cdr.html

[5] ALICE B. LLOYD, *Can't Repay Your Loan? Sue Your College! A Department of Education proposal gets closer to being a reality*., the weekly Standard, OCT 17, 2016