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ED Settles on Less Ambitious Overhaul of Borrower Defense

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In brief…

The Department of Education recently published its long-awaited, final rule detailing how the agency will process borrower defense and other loan discharges related to its Federal Direct Loan Program. The final rule applies to all loans disbursed on or after July 1, 2020 and departs from the agency's approach to adjudicating claims under the Obama administration.

The Department of Education (ED) recently published its long-awaited, final rule detailing how the agency will process borrower defenses and other loan discharges related to its Federal Direct Loan Program (i.e., loan forgiveness for borrowers). ED estimates this will generate annualized cost savings of $4.7 million—making it a deregulatory action under Executive Order 13771.[i] The final rule applies to all loans disbursed on or after July 1, 2020 and enacts various policy changes to the approach ED had taken under the Obama administration.

In this commentary I provide an overview of the history of Borrower Defense and focus on four outcomes of the current rule that were the subject of my public comment on the agency's 2018 notice of proposed rulemaking (NPRM). ED's final rule is a substantively less ambitious departure from its current approach than what it had originally proposed. The agency received over 38,000 public comments on its 2018 NPRM, and says these comments informed its current approach. It is also likely that ED's repeated losses in court related to previous regulatory actions on borrower defense also affected its rulemaking. Altogether, ED's final rule is an improvement to its 2018 NPRM.

A Review of Borrower Defense

ED issued its first Borrower Defense rule in 1994 under its authority to specify "which acts or omissions of an institution of higher education" would result in the agency granting forgiveness of a borrower's student loan debt. ED initially relied on individual state laws to set the standard; although it originally planned to issue more detailed guidance, it did not revisit borrower defense—partly because it received fewer than 10 claims each year. This changed in 2015 after the closure of several large institutions including Corinthian College resulted in ED processing over 100,000 claims.

The agency argued it needed a single, federal standard to efficiently adjudicate borrower defense claims going forward and issued its 2016 final rule towards the end of the Obama administration. The 2016 rule:

- Expanded the conditions under which ED would approve borrower defense claims,
- Added provisions broadening ED's ability to recover these losses directly from institutions, and

- Specified conditions and events that would generate "automatic triggers" for postsecondary institutions—additional requirements for schools to continue being eligible to be paid by borrowers using federal funds.

The original effective date of the Obama-era rule was July 1, 2017. However, the California Association of Private Postsecondary Schools (CAPPS) filed a court challenge to the 2016 rule on May 24, 2017. In response, under the Trump administration, ED issued multiple effective date delays to the rule, citing its authority under section 705 of the Administrative Procedure Act (APA) to postpone the effective date of regulations "[w]hen an agency finds that justice so requires…pending judicial review." In addition, it issued an NPRM on July 31, 2018 to rescind a majority of the changes made by its 2016 final rule—which had not yet taken effect.

Shortly after ED's initial effective date delay, a coalition of student borrowers and states attorneys general sued to invalidate the agency's Section 705 Stay. As ED issued additional delays, the student borrowers and attorneys general expanded their complaint to include the additional actions. The U.S. District Court for the District of Columbia consolidated the cases, and on September 12, 2018 ruled that the delays were "arbitrary and capricious and thus unlawful under the…APA." The Court vacated the delays pending resolution of the original CAPPS petition (which the Court then denied on October 16, 2018). As a result, ED's 2016 final rule became effective—becoming the new baseline against which its current proposal is measured. Barring any successful court challenges, the 2019 final rule details how the agency will now implement its Borrower Defense policies.

Problematically, the agency's own data indicate that it has not processed a single borrower defense claim for at least the last year and a half. This includes a full year for which the agency's 2016 borrower defense regulations have been in effect. As of June 30, 2019, ED had a backlog of over 200,000 claims pending review and is currently facing legal action over its refusal to process borrower defense applications under Secretary DeVos.

Results of Recommendations on the 2018 NPRM

In my public comment to the agency on its 2018 NPRM, I offered evidence in support of four recommendations: 1) ED should not use its 2016 definition of "substantial misrepresentation" to adjudicate claims; 2) it should treat borrowers from different types of schools consistently; 3) borrowers should be allowed to file affirmative borrower defense claims; and 4) the agency should consider retaining its group discharge process.

1. ED should not rely on the definition of "substantial misrepresentation" established in its 2016 final rule for adjudicating borrower defense claims. The language suggested by the agency in its 2018 NPRM better complied with existing executive requirements to design regulations in a cost-effective manner.

In its 2019 final rule, ED stated that it will not rely on its 2016 definition of "substantial misrepresentation" to adjudicate borrower defense claims. Instead, it adopts the language proposed in its 2018 NPRM—with some notable exceptions.

For instance, ED retained its 2016 change to the definition of "substantial misrepresentation" (i.e., the lower standard) as "appropriate for proceedings against schools in which the Department seeks to recover liabilities." The agency also added a non-exhaustive list of eleven cases where evidence would likely suggest that a misrepresentation had occurred (e.g., employment rates materially differ from an institution's marketing materials, an institution misrepresents the amount or timing of its tuition fees, etc.)

Additionally, the final rule accepts a less stringent evidentiary standard for borrowers to meet in their claims to the Department. In its 2018 NPRM, ED proposed to increase its standard from "a preponderance of the evidence" to the more stringent "clear and convincing" standard. Ultimately, the agency decided that the more stringent standard would "make it too difficult for borrowers to obtain relief." ED stated in its final rule that it agreed with commenters who noted that "a preponderance of the evidence" is the typical standard used in most civil proceedings and that the agency uses this standard elsewhere in its treatment of similar borrower debt issues.

2. ED's 2018 proposal not to make *a priori* assumptions about the quality of non-profit vs for-profit schools is preferable to its approach in 2016; students attending selective, non-profit institutions should qualify for relief via borrower defense.

In its final action, ED sets consistent and clear rules for both types of institutions and provides an opportunity for all borrowers to bring claims of misrepresentation to the agency. This decision expands the benefits of borrower defense protections to students at selective, non-profit institutions who were previously not eligible for relief—even in cases where a school was found to have misrepresented itself to students. This was a result of the agency's position in 2016 that "borrower[s] received a selective liberal arts education which represents the value that he could reasonably expect."

3. ED should retain its 2016 approach to allow borrowers to file affirmative borrower defense claims. Borrowers should not have to wait until they are in default to apply as it generates unnecessary costs and additional unintended consequences for borrowers.

In its final rule, ED retained its 2016 policy of accepting affirmative borrower defense claims. Evidence suggests that this approach is preferable to waiting until borrowers face collection action for at least two reasons: 1) it avoids unnecessary costs to consumers whose access to credit might be reduced due to a collection action by ED and 2) it ameliorates a moral hazard problem—where borrowers might strategically default on their loans to qualify for debt relief.

4. ED should retain its 2016 policy of using a group discharge process rather than committing itself to processing all claims on a case-by-case basis.

ED opted not to include policies for processing group borrower defense claims—a reversal of the agency's position in 2016 that group discharges could "conserve the Department's administrative resources" (i.e., process claims more efficiently). In my public comment to ED, I reasoned that an Inspector General report provided strong evidence that a group discharge process might allow agency staff to process roughly five times as many claims each month. Although it may be appropriate to consider many claims on a case-by-case basis, it seems unnecessary for the agency to forgo the option to avail itself of a group discharge process, altogether. This decision is most surprising given the aforementioned backlog of over 200,000 borrower defense claims awaiting processing.

[i] According to OMB's accounting guidance for EO 13771, this amounts to a present value cost savings of approximately $67 million.