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Written Testimony of Robyn Smith, Of Counsel to the National Consumer Law Center, in Response to the April 11, 2013 U.S. Department of Education Notice of Establishment of Negotiated Rulemaking Committees and Notice of Public Hearings

Submitted: June 4, 2013

I. Introduction

The following testimony is submitted on behalf of the National Consumer Law Center's low-income clients. The National Consumer Law Center (NCLC) is a nonprofit organization specializing in consumer issues on behalf of low-income people. We work with thousands of legal services, government and private attorneys and their clients, as well as community groups and organizations that represent low-income and older individuals on consumer issues. NCLC's Student Loan Borrower Assistance Project provides information about rights and responsibilities for student borrowers and advocates. We also seek to increase public understanding of student lending issues and to identify policy solutions to promote access to education, lessen student debt burdens and make loan repayment more manageable.[1]

Persistent abuses and fraud in the for-profit college sector shatter the hopes and aspirations of many students seeking higher education. At the NCLC's Student Loan Borrower Assistance Project, we see the harm to students on a regular basis through our direct client representation work. We also consult with legal services and other attorneys across the country who represent borrowers, many of whom have been harmed by for-profit schools. In addition, a large percentage of the complaints we receive through our Student Loan Borrower Assistance web site involve for-profit schools.

We commend the Department for holding public hearings and initiating rulemaking sessions in order to consider regulations that will help curb abuses. Strong gainful employment standards are an essential step toward deterring future abuses and ensuring that federal funds go to schools that provide quality education. Such rules, however, should also provide relief to the students who enrolled at schools that fail gainful employment measures and lose Title IV eligibility. We therefore urge the Department to offer targeted and comprehensive relief to borrowers who are harmed by illegal and deceptive practices.

[1] See the Project's web site at www.studentloanborrowerassistance.org. NCLC also publishes and annually supplements treatises which describe the law currently applicable to all types of consumer transactions, including Student Loan Law (4th ed. 2010 and Supp.)

For this rulemaking session, however, we ask the Department to reconsider the structure and process of negotiated rulemaking. The Department has granted a place at the table for the diverse voices from the educational and financial community. Yet it has failed to both recognize the incredible diversity among students and borrowers and to make a place at the table for these different voices. While students are the supposed beneficiaries of the system, the stakeholders who represent educational and financial interests do not engage in a true give-and-take process that is grounded in students' best interests. Instead, their voices often drown out the few borrower/student voices at the table and the resulting regulations, while leading to incremental improvements, do not benefit students or borrowers in the way that they should.

Now that the Department has roughly twenty years of experience with the negotiated rulemaking process, we believe that it is time for an assessment of the effectiveness of the process. We suggest the Department assess how the process can better incorporate the voices of students, prospective students, borrowers, parents and other central stakeholders that have modest organizational capacity (e.g., for-profit school students), so that the resulting regulations ultimately have a greater benefit for students and borrowers. In addition, while it is clearly important for students and consumer advocates to be at the table, it is also critically important that the Department itself be on their side, not a mere referee among unequals. We look forward to discussing this with the Department in order to make this process as fair as possible.

We also urge the Department to more aggressively enforce existing regulations that would help curb deceptive practices, for example the incentive compensation rules and the regulations regarding substantial misrepresentations.[2] Enforcement is necessary to reduce the rampant fraud and abuse in the for-profit school sector and ensure that federal dollars are spent at schools that provide quality education.

We offer comments on gainful employment, state authorization of distance education programs, the definition of "adverse credit history" for the Direct PLUS program, and the disbursement of federal aid to student accounts. We also request that the Department consider a number of other issues in the coming negotiated rulemaking session. We are not including issues resolved at the last round of negotiating rulemaking in 2011. However, we are very concerned that the Department has not yet issued the second package of proposed regulations negotiated at those sessions. These include some critical regulations, including reasonable and affordable payments for rehabilitation and amendments to closed school discharge regulations. We request that the Department provide information as soon as possible about the status of these proposed regulations.

II. Gainful Employment

We strongly support the Department's efforts to curb abuses in the for-profit school sector. Setting a gainful employment standard is a critical part of these efforts. Schools that

[2] 34 C.F.R. §§ 668.71 to 668.74 (to the extent still in effect after *APSCU v. Duncan*, 681 F.3d 427 (D.C. Cir. 2012).)

offer career education programs should be held to a high standard, which will help ensure that borrowers who enroll in career education programs have a reasonable expectation that they are in fact attending a program that is likely to lead to gainful employment.

Among the hundreds of clients we have represented over the years who have enrolled in propriety schools, only a handful of them have reported finding a job in the field related to their program of instruction. A large part of the blame clearly lies with schools that aggressively recruit students with false promises of job placement and employment, then fail to deliver. A gainful employment rule, if strengthened as we have recommended in previously submitted comments, can go a long way toward eliminating the worst programs.

Although we generally support the gainful employment framework that the Department previously finalized, we believe that those thresholds were too weak. The prior rule would have allowed programs to continue to profit from federal student aid, even when a majority of their former students with loans could not afford to pay down loan principal. In addition, the Department would have allowed programs that failed the weak gainful employment standards to continue to receive Title IV funds as long as they did not fail the standards 3 out of 4 years. Allowing career education programs that do not in fact prepare the majority of their students for gainful employment to enroll more students with federal funds – even after they have failed the gainful employment standard and continue to do so for up to 2 out of 3 additional years – is a huge disservice to the students and taxpayers who would end up with more defaulted student debt. In the next rulemaking session, we hope the Department will prioritize the needs and concerns of borrowers and taxpayers, rather than the industry, and draft a new rule that reflects these priorities.

In order to avoid repetition, we are not submitting detailed comments regarding gainful employment, other than with respect to student relief (below). We instead incorporate the written comments we previously submitted regarding the proposed gainful employment rule published July 26, 2010 (75 Fed. Reg. 43616), which are attached as Appendix A.

III. Student Loan Borrower Relief

All too often, the needs and concerns of the very people who the federal financial aid program was created to benefit – the students – get lost amid discussions about minimum standards, the processes for calculating and applying those standards, the fiscal concerns of taxpayers and the government, and industry concerns. The following recommendations for consideration at the upcoming negotiated rulemaking therefore focus on strengthening relief for low-income borrowers, particularly those who are harmed by school abuses. We highlight issues that we believe can be addressed through the regulatory process and hope that the Department will prioritize borrower needs in future rulemaking sessions.

Although the Department has taken numerous actions in the past few years to tackle abuse in the for-profit school sector, these actions have done little or nothing to provide relief for the students already harmed by these abuses. Regulations aimed at shutting off the federal financial aid stream to abusive for-profit schools will prevent future students from obtaining insurmountable debt to attend those schools. Such regulations, however, should also provide relief for students who were enrolled at or near the time such schools lose their eligibility to receive Title IV funds.

In addition, there are countless borrowers who have already been harmed by abusive practices and are subject to the government's draconian collection powers. We see a continuous stream of new clients who are still struggling with 10, 20, and 30-year old loans – even though they attended schools that engaged in deceptive practices that violated both federal and/or state laws. Our experience unfortunately has also shown that there will always be some schools that try to take advantage of borrowers. The problems are particularly prevalent in the for-profit higher education sector where all too often schools prey on vulnerable students' dreams of betterment through education. As a result, the financial assistance that was intended to help these students does little more than bury them in a lifetime of debt. We therefore hope that the Department will consider providing these borrowers relief by expanding and clarifying existing student loan cancellation programs.

A. Provide Relief for Borrowers in Programs that Fail Gainful Employment Standards

In the previous final version of the gainful employment rule, the Department would have allowed failing programs to continue receiving federal funds and enrolling students as long as they did not fail for three out of the four most recent fiscal years.[3] Thus, the Department would have allowed substandard schools unable to prepare even a majority of their students for gainful employment to enroll up to three additional years of students. Most of these students would end up with enormous debt and little likelihood of ever being able to pay it off.

Our clients' experiences illustrate the harm done by prolonging an unproductive, debt-ridden school experience. We have countless stories of clients staying in a program, despite very early warnings that the program would not prepare them for employment. For example, a group of our clients attended a local for-profit medical assistant program. These clients did not have high school diplomas or G.E.D.s when they signed up for school. They had numerous complaints about the program. When some of the clients raised concerns, they were told that they might as well try to finish because they were going to have to pay back their loans anyway. Although in fact they could have received partial refunds, the students believed these misrepresentations and stayed in school. They tried to find work after completing, but each was told numerous times by prospective employers that they do not hire individuals without high school diplomas. A few of our clients had asked the school staff at the beginning whether this would be a problem. They were reassured that many graduates without high school diplomas find work in the field. Some of our clients were also told by employers that they never hire graduates from this for-profit school.

[3] 34 C.F.R. § 668.7(i) (76 Fed. Reg. 34448 (June 13, 2011)).

These clients are devastated by the time and resources they wasted at this school. Even worse, they are saddled with student loan debts they cannot repay. The most comprehensive remedies, statutory discharges, are available to only a small subset of borrowers suffering harm.

We strongly recommend that the Department stop funding programs as soon as they fail gainful employment standards and provide relief for borrowers. It is also important to ensure that relief is provided to the affected borrowers. We therefore recommend, at a minimum, that the Department include the following relief in any future gainful employment regulations:

1. Full loan discharges for any student who cannot complete a program due to loss of eligibility under the gainful employment process.
2. Full discharges for any student who enrolled in a program that lost eligibility because it failed the gainful employment standards, regardless of whether the student completed the program. Any student who attended between the time that the program first failed the gainful employment standards and the loss of eligibility should qualify.
3. Allow borrowers to raise as a defense to collection that they are in the groups described in numbers 1 or 2 above.

There is authority in current statute and regulations for these types of discharges. The authority for closed school discharges in 20 U.S.C. § 1087(c)(1) states that loans must be canceled if a student is unable to complete the program in which the student is enrolled due to the closure of the institution. This should apply to circumstances in which the borrower's program of study was closed because of ineligibility under the gainful employment standards.

The same statutory provision also provides for discharge if the student's eligibility to borrow was falsely certified by the eligible institution. This provision should apply as well to any student who enrolled in a program after it had failed the gainful employment standard and before it lost eligibility based on this failure. In addition to the statutory discharges, the Department also has general authority to compromise loans.[4]

The Department should also seek reimbursement from the schools for discharges granted to borrowers.[5]

Even this level of relief will not be enough for many borrowers. The recommendations above are critical, but in our experience, such relief will be far from

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[4] See, e.g., 20 U.S.C. § 1082(a) (FFEL); 31 U.S.C. § 3711 (general authority to compromise government debts); and 34 C.F.R. § 30.70.

[5] For example, for discharges granted under the closed school or false certification authority, the regulations provide that after discharge, the borrower is required to cooperate with the Secretary to recover for amounts discharged. 34 C.F.R. §§ 682.402(e)(4) (FFEL false certification); 685.215(b)(6)(ii) (Direct Loans).

complete because so many borrowers also have private loans and institutional debts. We urge the Department to work with other federal agencies to seek solutions for these debt burdens as well, including by supporting full bankruptcy relief for private student loan borrowers.

B. Broaden Existing School-Related Cancellations

The three main types of cancellations (or "discharges") that are intended to address fraud are closed school, false certification, and unpaid refund cancellations. It is important to emphasize that these types of discharges offer relief only for a narrow set of circumstances. They are not available to students who attend schools that engage in other kinds of deceptive practices, including those that are prohibited by federal regulation. For example, a school may routinely pay admissions officers by commission, fail to provide educational materials or qualified teachers, or misrepresent a student's likelihood of finding a job or earning a particular salary after completion.[6] None of these violations is a ground for student loan discharge. We recommend that the Department consider new cancellations that will afford relief to all borrowers who attend schools that violate key Higher Education Act regulations and for borrowers who have secured judgments against schools based on HEA regulation violations, but who are unable to collect from the school or other sources (such as state student tuition reimbursement funds).

It is also important to emphasize that the Department currently has the authority under the HEA to broaden discharge relief as we suggest and does not need additional statutory authority to do so. As noted above, the Department has general authority to compromise loans.[7] In addition, as described below, with respect to Direct Loans the Secretary may specify "acts or omissions . . . a borrower may assert as a defense to repayment of a loan made under this part . . . ."[8] The Department has discretion to decide which acts or omissions constitute a defense to loan repayment and how borrowers may assert that defense. The Department could define such acts or omissions to include false certification, among other things, and allow the borrower to assert such defenses through an expanded discharge process.

With respect to the existing cancellation programs, we urge the Department to make relief more broadly available to harmed students by adding the following items to the upcoming negotiated rulemaking agenda:

1. **Expand and Clarify False Certification Cancellation Provisions**. We continue to see new clients whose loan eligibility has been falsely certified by for-

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[6] See 34 C.F.R. §§ 668.14(b)(22) (prohibiting the payment of incentive compensation for securing enrollments);); and 668.71(b) (prohibiting substantial misrepresentations, including about the nature of a schools' educational programs and the employability of its graduates).
[7] See, e.g., 20 U.S.C. § 1082(a) (FFEL); 31 U.S.C. § 3711 (general authority to compromise government debts); and 34 C.F.R. § 30.70.
[8] 20 U.S.C. § 1087e(h).

profit schools. For example, we have recent clients who were falsely certified by schools that engaged in widespread ability-to-benefit ("ATB") violations, but who continue to face debt collection for the student loans they obtained to attend those schools over 20 years ago. For a number of reasons, highlighted below, many borrowers who have been harmed by for-profit school fraud have difficulty obtaining discharges for which they should qualify.

a. Broaden Relief to Conform to Statutory Authority. The regulations should be amended to conform to the broader relief provided for in the authorizing statute. Relief should not be primarily limited to borrowers whose ability to benefit is falsely certified.

In addition, the Department has taken a very restrictive interpretation of the "disqualifying" status basis for false certification.[9] Many borrowers that legitimately could not have been employed in the fields allegedly trained for are denied relief. The regulations should be clarified to address this inequity. For example, the regulations should clarify that borrowers are eligible for relief if they are not proficient in English, but are enrolled in courses given in English or that lead to an employment field that requires English proficiency. Borrowers should also be eligible for relief in cases where a program lacks accreditation so that graduates are ineligible to take licensing or other required state employment exams.[10]

b. Make Burdens of Proof Fair for Borrowers. The Department should specify that borrowers that submit a sworn statement establishing their eligibility for a false certification discharge are presumptively eligible for discharge. Once presumptive eligibility is established based on a borrower's application, the burden should then shift to the Department to disprove the borrower's eligibility. Absent any evidence contradicting the borrower's sworn statement or disputing the borrower's credibility, the regulations should specify that the Department must grant the discharge.

Currently, although a student's sworn statement is a valid form of evidence, the Department regularly requires borrowers to present additional independent evidence before it will grant discharge applications, particularly for ATB falsification discharges. The Department, for example, often requires proof of federal or state investigatory findings of fraud. Many borrowers cannot provide proof of federal or state investigations of particular schools because enforcement has been so lax that no such investigations exist. This, however, does not mean that the violations did not happen. The Department unfairly relies on a 1995 Dear Colleague letter that states an absence of

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[9] 34 C.F.R. §§ 682.402(e)(iii)(B) (FFEL); 685.215(a)(1)(iii) (Direct Loans).
[10] See, e.g., Testimony of Yasmine Issa before the Senate, Heath, Education and Labor Committee, Hearing on Federal Spending on For-Profit Education (June 24, 2010), available at http://help.senate.gov/imo/media/doc/Issa.pdf (last accessed on May 7, 2013).

findings of improper practices raises an inference that no improper practices were reported because none were taking place.[11] The regulations should clarify that the Department should look not only for evidence of findings from oversight agencies, but examine other evidence as well, including any student complaints or other false certification applications with similar sworn student statements.

In addition, the Department should reinforce in regulation the guidance in the 2007 Dear Colleague letter for FFEL loans requiring agencies to check for the availability of evidence to support false certification allegations and to make inferences in certain circumstances that problems or violations have occurred.[12] The Department should also keep all of the following evidence indefinitely, given that there is no statute of limitations applicable to government student loans, and should provide this evidence (with appropriate redactions for privacy purposes) to borrowers on request.: (1) all evidence that it collects in evaluating discharge applications; (2) all discharge applications, which can also serve as corroborating evidence to support other discharge applications; and (3) all evidence gathered in or findings after any kind of school review or investigation that demonstrates any potential violation that would serve as a basis for a student loan discharge. The Department should revoke any document retention policies that would allow the destruction of this kind of evidence.

c. Expand the Use of Group Discharges. In cases where there is proof that a school engaged in systemic violations that provide a basis for some type of loan discharge relief, the Department should affirmatively grant group discharges to appropriate cohorts of borrowers.

Individual borrowers do not have access to the full range of information that guaranty agencies and the Department collect about student complaints, evidence related to other false certification discharges, and other key information. The Department should therefore track such evidence and grant group discharges whenever it has evidence that a school committed pervasive violations that would serve as grounds for loan cancellation.

2. Apply Relief to Borrowers with Older Loans. We also urge the Department to apply relief to borrowers with older loans, not only those with loans incurred at least in part on or after January 1, 1986. We have seen many clients who obtained loans prior to 1986 and were subjected to illegal practices that would be grounds for seeking loan cancellation if the loans were made after 1986 – but who are still struggling with defaulted student loans. Relief should be extended to loans obtained before 1986 for all types of statutory discharges.

[11] U.S. Department of Education, Dear Colleague Letter Gen-95-42 (Sept. 1995).
[12] U.S. Department of Education, Dear Colleague Letter No. FP-07-09 (Sept. 20, 2007).

C. Allow Borrowers to Assert Schools' Federal or State Law Violations as Defenses to Repayment of Direct Loans at Any Time

Many students who were subjected to deceptive and abusive practices of for-profit schools do not qualify for any type of statutory loan cancellation. They should be able to assert as a defense to loan repayment the school's state or federal violations at any time.

For example, a group of recent clients at a legal services organization in Los Angeles attended a for-profit school that represented that its medical assisting program would be conducted entirely in Spanish. Upon enrollment, the students, none of whom read or understood English, discovered that instruction, class materials, and even exams were all in English. In addition, there were a number of other problems with the program, including unqualified instructors and placement in internships that did not require the use of medical assisting skills, but instead required janitorial work. Because school officials misrepresented the students rights' to withdraw, all of the students struggled through the entire course in the hopes that they would learn the skills they needed to obtain a medical assisting job. Only one student, out of about 40 legal aid clients, found a medical assisting job. Many of these students, however, do not qualify for any kind of statutory loan cancellation. Many of them had high schools diplomas and the Department does not recognize language barriers as grounds for a false certification discharge based on "disqualifying status." Although the school eventually closed, all of the students completed their programs 2 or 3 years before the school's closure.

These students should be able to raise these claims as defenses to loan repayment at any time. With respect to Direct Loans, however, the regulations state, "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."[13] The Department should change this regulation in two ways. First, it should eliminate the provision limiting claims to those available under state law. Because there is no such limit in the authorizing statute, the regulation should allow the student to raise defenses based on a cause of action under any applicable law, state or federal.[14]

Second, the Department should eliminate the provision allowing students to assert defenses only in a "proceeding." The regulation defines "proceedings" as tax refund and federal salary offsets, wage garnishments, and "credit bureau reporting proceedings." Again, this limitation does not exist in the authorizing statute. Students should not have to wait until they are in default and facing one of these types of processes, which do not even include Social Security offsets, to raise school-related defenses. Instead, the regulation should be amended to allow borrowers to raise school-related defenses against the repayment of Direct Loans at any time.

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[13] 34 C.F.R. § 685.206(c)(1).
[14] 20 U.S.C. § 1087e(h).

Finally, the Department should provide a clear and fair process by which students may raise school-related defenses. If such a process already exists, we ask that the Department provide information so that it is transparent.

IV. Distance Education

We strongly support the Department's statement, in support of the regulations it proposed in October 2010, that the HEA's state authorization requirement is a "substantive requirement."[15] The Department emphasized that states are "key participants" of the regulatory triad and should "retain the primary role and responsibility for student consumer protection against fraudulent and abusive practices by some postsecondary institutions."[16] We believe the Department made the right decision when it previously proposed a regulation that required schools to obtain state authorization in every state where they offered distance education programs, even in states where they had no physical presence. We urge the Department to propose this same rule after it has engaged in the required rulemaking process.

In addition, the Department should clearly provide that states may not rely on authorizations granted by other states. If the Department were to only require that distance education programs be authorized by the state in which it maintains its physical headquarters, or otherwise allowed states to rely on the authorization of such a state, we are concerned that for-profit schools would start a race to the bottom – moving their physical headquarters to states with the most lenient oversight and consumer protection laws. Time and again, we have seen other for-profit business do exactly this. For example, national banks may charge the highest interest rate allowed in the bank's home state, regardless of where the borrower lives. As a result, many national banks have located their headquarters in states with liberal or nonexistent usury laws, such as Delaware and South Dakota, so that they can "export" those state's high interest rates and avoid complying with the stricter usury laws of other states. There is no reason to believe that for-profit schools would act any differently.

The Department should also require that schools be subject to the complaint procedures and consumer protection laws of any state where they offer a distance education program, regardless of physical presence. Again, states should not be able to defer complaint investigation responsibilities, or their responsibility to take action against schools who violate state or federal law, to other states.

Unfortunately, many for-profit institutions continue to engage in deceptive and abusive business practices. As increasing numbers of for-profit institutions enter the on-line education market, where students are even more vulnerable to fraud, it is important that the Department do what it can to ensure that states are performing their primary consumer protection role within the triad.

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[15] 75 Fed. Reg. 34806-01, 34813 (June 18, 2010).
[16] 75 Fed. Reg. 66832-01, 66858 (Oct. 29, 2010).

V. "Adverse Credit History" for Direct PLUS Loan Eligibility

The Department should eliminate the current regulation which makes parents ineligible for PLUS loans when they have a recent bankruptcy discharge listed on their credit report.[17] This provision conflicts with a provision in the Bankruptcy Code which specifically prohibits the government and lenders from denying student loans to borrowers based on a prior bankruptcy.[18]

VI. Disbursement of Financial Aid to Student Accounts

Students should be able to decide where to bank and what type of account they use to manage their financial aid benefits. We are concerned, however, that too many schools may be steering students into using bank or prepaid card accounts offered by financial institutions that share revenue with schools whenever their students open accounts. These accounts often have limitations, including no checks, limited access to a full service financial institution, and excessive fees for a variety of everyday services such as depositing checks, getting cash, and checking one's balance at an ATM. Some accounts offer expensive credit features, such as advance payday loans and so-called "overdraft protection," which can get students into trouble. Many expose students to risk. For example, some are offered by institutions whose deposits are not insured.

We previously submitted extensive recommendations regarding these issues in written comments submitted in response to the May 1, 2012 Department Notice of Establishment of Negotiated Rulemaking Committees and Notice of Public Hearings (77 Fed. Reg. 25658). We recommended, for example, that the Department prohibit schools from sharing revenue with financial institutions. Rather than repeat those recommendations here, we have attached a copy of those comments as Exhibit B.

VII. Bona Fide and Reasonable Collection Charges

We urge the Department to terminate its use of private collection agencies to collect student loans. While the Department continues to use collection agencies, we ask that the Department consider revising its collection fee system so that it is more fair and equitable to borrowers.

Borrowers should only be charged for collection fees that are bona fide and reasonable and actually incurred. Currently, the Department uses a "cost-averaging" basis to calculate an individual borrower's collection fees.[19] The Department calculates the fees, which may be as high as 25% of outstanding principal and interest, based on the average collection cost per student loan borrower. The fees are not in any way related to the actual costs incurred in collecting from any particular borrower. This "cost-averaging" approach

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[17] 34 C.F.R. § 685.200(c)(1)(vii)(B)(2) (Direct Loans).
[18] 11 U.S.C. § 525(c).
[19] 34 C.F.R. § 30.60(d).

often leads to unfair results since the number of defaulting borrowers from whom recovery is made bear the brunt of all the government's collection expenses.

In many circumstances the Department adds these exorbitant collection fees to the principal balance, a standard practice known as capitalization. Capitalization leads to ballooning loan debts even in cases where collection activity is minimal. This practice of adding collection fees, which are often unrelated to the minimal amount of work actually performed by the collection agency, to the principal balance makes it even harder for borrowers to make a dent in paying off their debts.

Collection fees should only be charged when they are both reasonable and actual costs that have been incurred. In no case should such fees be charged for government offsets for wage garnishments. The fairest and most straightforward approach is to charge fees based on actual time and activity expended on each case, with a reasonable numerical ceiling. In addition, the amount of fees to be charged must be clearly written in the promissory note. In no event should fees be added to the principal.

We thank the Department for its courage and persistence on the gainful employment and state authorization issues, and for its consideration of our comments. Please feel free to contact Robyn Smith with any questions or comments. (Phone: (213) 840-6264; E-mail: rcsmith1000@gmail.com).

Appendix A

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National Consumer Law Center
Comments on
Program Integrity: Gainful Employment
Proposed Rule
Docket ID ED-2010-OPE-0012

Introduction

On behalf of our low-income clients, the National Consumer Law Center (NCLC)[1] is responding to the Department of Education's proposed gainful employment rule, published on July 26, 2010 (75 Fed. Reg. 43616).

We strongly support the Department's efforts to curb abuses in the proprietary school sector. Setting a "gainful employment" standard is a critical part of these efforts.

At the National Consumer Law Center, we see first-hand the harm caused by abusive proprietary school practices. A large percentage of our low-income clients attended proprietary schools. Most are in default on federal and private student loans. All of the clients we represent live in Massachusetts and are eligible for free legal services. We also work with lawyers across the country representing student loan borrowers. In addition, a large percentage of the complaints we get through our Student Loan Borrower Assistance web site involve proprietary schools.

Among the hundreds of clients we have represented over the years who have enrolled in proprietary schools, not a single individual has reported finding a job in the field related to the supposed training course. A large part of the blame clearly lies with schools that aggressively recruit students with false promises of job placement and employment, but fail to deliver. We believe that the proposed rule, particularly if it is strengthened as recommended below, can go a long way toward eliminating the worst programs and giving borrowers a real chance to succeed.

To participate in the federal aid programs, federal law requires career education programs to "prepare students for gainful employment in a recognized occupation." The proposed rule is essential because it defines this standard so that it can be enforced and so that the government has a consistent

[1] The National Consumer Law Center, Inc. is a nonprofit Massachusetts corporation, founded in 1969, specializing in consumer issues, with an emphasis on consumer credit. NCLC provides legal and technical consulting and assistance on consumer law issues to legal services, government, and private attorneys representing low-income consumers across the country. NCLC publishes a series of practice treatises and annual supplements on consumer credit laws, including *Student Loan Law* (3d ed. 2006 and Supp.), as well as bimonthly newsletters on a range of topics related to consumer credit issues and low-income consumers. NCLC's Student Loan Borrower Assistance Project provides information about student loan rights and responsibilities to borrowers and advocates. See www.studentloanborrowerassistance.org.

measurement to use in holding schools accountable. Most important, this will help ensure that borrowers have a reasonable expectation that they are in fact attending programs that are likely to lead to gainful employment.

This rule will be most effective if it is part of a comprehensive strategy to challenge fraud and abuse. We urge the Department of Education to work cooperatively with other federal agencies, including the FTC and the new Consumer Financial Protection Bureau, to challenge persistent problems and legal violations in this sector.[2] It is also critical to ensure that borrowers have tools to privately enforce these rules.

Comprehensive and aggressive enforcement is essential at all times, but we urge particular vigilance during the implementation period for this new "gainful employment" system. Enforcement is necessary to reduce the rampant fraud and abuse in the proprietary school sector and ensure that federal dollars are spent productively and efficiently.

Our comments on the proposed rule are not based on a belief that there should be just one particular model of education. As lawyers for low-income clients, we agree that there is a need to offer educational programs that meet the needs of many low-income and "non-traditional" students. Most of our clients are older than "traditional" students, often with their own children. They are looking for flexible schedules and in some cases on-line courses. Many do not have high school diplomas or G.E.Ds. These rules are essential to help ensure that these individuals will be given a real opportunity to succeed if they choose to pursue career training.

The Proposed Standards Must be Stronger <u>and</u> Provide Relief for Student Borrowers

The proposed rule is long overdue in setting a definition of gainful employment. We generally support the framework in the proposed rule, which requires schools to meet a repayment or debt/income standard to remain eligible for federal aid. However, as described in greater detail below, we believe that the thresholds are too weak. We believe that the Department went too far in listening to industry complaints that they would lose business if the rules were too strong. The Department of Education should be first and foremost concerned about the needs of borrowers and taxpayers and the rule should reflect these priorities.

It is shocking that the proposed rule would allow programs to continue to profit from federal student aid when a majority of their former students with loans cannot afford to pay down loan principal. As the Department documents in the NPRM and other sources, many schools, both non-profit and for-profit, have been able to stay in business with higher repayment rates. It is not only possible, but essential to set a high bar. Otherwise, the rule will allow the current race to the bottom to continue.

Given the focus on doing what is best for students, we also urge the Department to ensure that greater relief is provided to borrowers harmed by abusive school practices.

Our recommendations are presented in detail below.

1. **The Repayment Rate Formula: 34 C.F.R. § 668.7(a)(1)(i) and Definition of Repayment Rate in § 668.7(b)**

[2] See, e.g NCLC, PIRG and Public Advocates, Comments to the FTC, "Vocational School Guides Review" (Oct. 16, 2009), available at: http://www.studentloanborrowerassistance.org/blogs/wp-content/www.studentloanborrowerassistance.org/uploads/File/policy_briefs/FTCguides1009.pdf.

General

We agree with the Department's decision to consider only payments that reduce principal as "repayment" for these purposes. However, we are concerned that this concept will drift into other areas where payments will be considered "real" only if they reduce principal. We urge the Department to clarify that this definition of repayment is relevant only for these purposes.

Although it is far from ideal, many borrowers have no choice but to use repayment plans, such as IBR, that create negative amortization. These types of plans are often the only solutions we can find for our low-income clients, many of whom attended rip-off proprietary schools.

The current Higher Education Act statutory discharges provide relief for only a small subset of borrowers harmed by abusive and deceptive proprietary school practices.[3] Bankruptcy is rarely available for these borrowers given the heightened dischargeability standard. If a discharge is not available, these borrowers must look elsewhere to get out of default, in many cases so that they can go back to school.

We often assist our clients in getting out of default and then selecting affordable repayment plans. Many of our clients live on public assistance incomes as low as $300 or $400 monthly. They have $0 payment plans under IBR, which are clearly not making a dent in principal. The hope is that these clients can get back to work and repay principal at some point, but the reality is that many never reach this goal. They should not be stigmatized or penalized in these circumstances. The income-based repayment options are extremely important tools that should not be seen in any way as "lesser" payment plans.

We also agree with including completers and non-completers in the repayment formula. Studies of default rates consistently show that withdrawal from school is a key cause of default. These borrowers must be tracked to give an honest picture of school performance and to ensure that schools do not attempt to artificially keep students in school as a way of evading the gainful employment standards.

The Thresholds are Too Low

The Department found that the number of institutions in its analysis with very low loan repayment rates, particularly in the for-profit sector, was "alarmingly high." (NPRM p. 43619). We agree. For some reason, the Department then set a low bar, allowing programs with loan repayment rates as low as 35% to remain eligible for federal aid. The Department seems to be setting a low bar because of the expected impact. This is hardly an objective rationale. In other discussions in the NPRM, the Department focuses on the tremendous costs to borrowers and taxpayers of low repayment rates. Given these discussions, it is hard to understand how a rate of 35% could be considered acceptable.

While it is likely that the initial impact of a strong rule will lead to disqualification of numerous programs, this is a good thing if it means that schools that cannot meet the thresholds will drop out and that others will improve their programs. The Department is not doing any favors to borrowers by allowing programs with poor outcome measures to linger.

[3] See generally National Consumer Law Center, "No Way Out": Student Loans, Financial Distress and the Need for Policy Reform" (June 2006), available at: http://www.studentloanborrowerassistance.org/blogs/wp-content/www.studentloanborrowerassistance.org/uploads/File/nowayout.pdf.

The Department's thresholds are even lower than they may appear due to the exclusion of private loans and parent PLUS loans. In 2008-09, these two forms of debt accounted for 20% of all postsecondary education loans.[4] This highlights the need to increase the repayment rate thresholds and also the need to include private loans in the debt/income measure.

The Department also requested comment on whether there is a repayment rate threshold so low that no programs falling below it should remain eligible for federal aid, regardless of their debt-income ratios. We believe that programs with a calculated repayment rate of 35% or less should no longer be eligible to receive student aid.

The Loans Paid in Full (LPF) Category

We agree that the loans paid in full category (LPF) should not include consolidation loans unless the consolidation loans are paid off. This is reflected in the current regulations. Without this provision, schools could try to "game" the system by encouraging or pressuring borrowers to consolidate their loans. This was an issue particularly during the 90's when collection agencies and loan holders often consolidated loans without borrower consent.

We have questions, however, about how the Department will track the underlying loans in consolidation loans. A consolidation loan could be comprised of loans from a number of different programs. Yet the repayment rate is set program by program. We raise this point to ensure that the Department will have a way to track this information.

The Reduced Principal Loan (RPL) Category

We agree with the Department's goals in including loans in the repayment (RPL) category for borrowers whose payments during that year qualify for the public service loan forgiveness program (PSLF). However, we are concerned about a number of possible negative unintended consequences from this provision. We are also concerned that the regulation does not address the way other discharges will be handled.

With respect to PSLF, we agree that creating disincentives to participate in PSLF would not be a good outcome. However, it is unclear what it means to "qualify" for PSLF. Currently, there is no system in place for borrowers to qualify year to year. We assume that the Department intends to create a process so that borrowers can submit information about their employers and receive some confirmation that they "qualify" for PSLF for that year. NCLC and many other groups have advocated this system for some time.

In creating this system, the Department should be clear whether confirmation of PSLF for these purposes will be determinative if the borrower later applies for PSLF. If so, the borrower should have to submit information not only about the employer, but also evidence that she is working full-time. Only full-time employees are eligible for PSLF.

We recommend that the annual "qualification" should be determinative if the borrower later applies for PSLF. It must also be rigorous enough so that schools do not try to game the

[4] Calculations by the Institute for College Access & Success on data from College Board, *Trends in Student Aid, 2009,* Tables 2a and 2b (2008-09 loan volume data is preliminary).

system by encouraging borrowers to claim that they are seeking PSLF when they clearly would not qualify. The Department should be alert to abuses in this area. For example, a high number of borrowers in PSLF status from cosmetology schools or other schools where students are unlikely to find jobs with public service employers should be a warning sign of rule evasion.

The Department should also be clear about when it will measure PSLF. Is a loan considered to be in PSLF status if it held that status the entire year, a majority of the year, or just a few months? Depending on how the Department implements this provision, there are different concerns to be considered, each with specific implications.

The Department should also clarify that borrowers can continue to self-certify their intent to participate in PSLF for purposes of consolidating with Direct Loans.[5]

The regulations are silent about how other discharges will be treated in the formula. We recommend that:

A. Loans where a borrower has received a school-related discharge (closed school, false certification, and unpaid refund) should not be counted as paid in full. This would be rewarding schools for their own transgressions. These loans should be considered as outstanding loans (OOPB) for the entire period.
B. Discharges related to personal circumstances such as disability or death should be counted as paid in full. These discharges are difficult to obtain. There should therefore be little concern that schools will pressure borrowers to apply. Borrowers or their survivors should also not be discouraged from applying for these discharges by schools concerned about the impact on their repayment rates.
C. Other profession-related discharges, such as Perkins discharges, should be treated similarly as PSLF as long as there is some system to check whether borrowers qualify.

Potential Problems with Rule Evasion

We have other concerns about potential gaming of the repayment rate. The recommendations above should help address this prospect, but it is impossible to plan for all ways in which unscrupulous school operators will seek to evade penalties. Therefore, we strongly recommend that the Department conduct regular audits of the gainful employment system, looking for abuses.

The Department should be alert not just to low LPF rates but also to consistently high LPF rates. In general, few schools should show high rates of loans paid in full during the relatively short period of time that repayment is tracked. Those that do exhibit high rates may be abusing the system by encouraging discharges as described above. They may also be paying off their students' federal loan debts, then seeking to collect separately as debts owed to the school. We know this can happen because it has happened in the past and is allegedly happening now as schools seek to avoid default rate sanctions. Another sign to look for is high rates of private student loan borrowing at particular schools. This may signal that schools are pressuring borrowers to take out private instead of federal loans. As discussed below, the schools may not accurately count private loans as part of the debt to income measure. Yet even with high rates of

[5] Se 34 C.F.R. § 685.220(d)(1)(i)(B)(3).

private loan borrowing, they could retain eligibility through the repayment standard, which does not account for private loan debt.

Timing of Repayment Period and Look Back Period

We are concerned about the short look back period in the repayment rate formula. Many studies show that default rates grow consistently over time. A recent study by the Texas Guaranty Agency analyzed data beyond the cohort default period to address whether common assumptions about default causes hold true over the long term. [6] The agency found, consistent with other studies, that borrowers who withdraw from school are more likely to default soon after departure. However, they also found that although borrowers who graduate avoid defaulting longer, they also begin defaulting in significant numbers beyond the cohort default window.[7]

The longer the period, the less likely the school will be able to manipulate the data. We believe that repayment should be tracked over a longer period of time, possibly six years, to provide a more accurate picture of the borrower experience and to encourage schools to lower tuition and reduce borrowing rates. Borrowers who become totally disabled or die during this time can have loans discharged and their loans will no longer be in repayment.

We recognize that setting too long of a look back period at the outset will delay implementation. This rule is critical and should be in place as soon as possible. We therefore recommend that the longer look back period be phased in over time.

The Repayment Category Must Not Include Borrowers in Deferment, Forbearances, Default or Delinquency

Another huge area of concern is that the reduced principal payment category (RPL) could arguably include all borrowers who made any payments that reduced principal during the last fiscal year regardless of their current repayment status. We recommend that the repayment rate measure BOTH whether there was a reduction in principal during the fiscal year and whether the loan is actively being repaid. The preamble language suggests that this was the Department's intent, but the proposed regulation appears to measure only whether the principal has been reduced.

The proposed regulation at § 668.7(b)(3) describes the RPL as including loans where payments made by a borrower during the most recently completed FFY reduced the outstanding principal balance of that loan from the beginning of that FFY. Although the regulations refer to payments rather than payment, it is conceivable that a borrower could make two payments that reduce principal, become delinquent, even go into default, but still be placed in the repayment category (RPL). These borrowers could even presumably make two payments and then go into deferment or forbearance. Yet the Department states in the introduction that no borrower in

[6] Texas Guaranteed Student Loan Corporation, "White Paper: Crisis Averted or Merely Postponed?: Examining Long-term Cohort Default Rates, Resolving Defaults, and Curing Delinquencies" (July 2010), available at: http://www.tgslc.org/pdf/crisis_averted.pdf.

[7] Id. at 7.

deferment or forbearance (other than in-school or military) will be counted as in repayment. (NPRM p. 43619).

The Department could address this concern by first gathering information about all borrowers who reduced their principal through repayment and then excluding anyone in forbearance, deferment (other than in-school or military) or default at the end of the period. The formula would then take into account not only whether there was a reduction in principal at the end of the fiscal year, but also whether the borrower is in a current repayment status at that time. This should at a minimum be done at the end of the fiscal year. However, this is still only a snapshot in time and does not account for borrowers who later become delinquent, get a forbearance or deferment or are otherwise not in active repayment. Regardless, the Department should clarify when the determination of loan status will be made.

We strongly recommend that in addition to deferment, forbearance and certain discharge categories as discussed above, the Department also exclude from repayment (RPL) loans in which the borrower has been in delinquency status for more than 45 days. The 45 day allowance is so that borrowers that missed only one payment, but are back in repayment, are included in the RPL category.

The Department should be attuned to schools that may try to discourage students from choosing options that work best for the borrowers, but may adversely affect the school's repayment rate. Deferments, for example, are critically important options for many borrowers. Other than in-school and military deferments, which are included in the RPL rate, most other deferments are available only for unemployed borrowers and those facing severe economic hardship. Borrowers in these categories should not be counted in the RPL formula.

Consider Only Reductions of Principal Due to Voluntary Payments

A reduction of principal due to involuntary payments should not be considered in the RPL category. Most borrowers that default during the fiscal year are unlikely to see a reduction in their principal balances at the end of the year given the fees and collection costs that are added to these borrowers' accounts. However, if the formula takes into account large involuntary payments, such as seizure of an earned income tax credit, the account could show a reduction in principal even if the borrower did not make any voluntary payments.

The regulations state that only payments "made by a borrower" are counted in the RPL category. Arguably, involuntary payments are not "made by a borrower." We recommend that the Department make this clear by specifying that only voluntary payments made by a borrower are counted in the RPL formula.

2. Debt/Income Category: 34 C.F.R. § 668.7(a)(1)(ii), (iii) and Definitions in § 668.7(c)

The Debt/Income Thresholds Are Too High

The Department justifies the 8% of average annual earnings standard by pointing to its use by mortgage lenders and other creditors. (NPRM p. 43620). However, this standard is usually intended to cover all non-mortgage debt, including car payments, credit cards and other debts. The threshold for student loans should be lower since most borrowers with student loans are also struggling to pay other essential debts and expenses. This is certainly true of most of our clients. We recommend a threshold of 5% as a more realistic standard if the prior three year period data is used and 8% only for the rate using the three year period data.

The rates based on discretionary income are also too high. The Department states that a debt-to-discretionary income ratio of 30% or higher is clearly excessive. This conclusion is based largely on research by Sandy Baum and Saul Schwartz.[8] However, it does not accurately reflect the research. Baum and Schwartz concluded that the percentage of income borrowers can reasonably be expected to devote to student loan repayment increases with income. They noted that borrowers with incomes near the median should not devote more than about 10% of their incomes to education debt repayment and that the payment-to-income ratio should never exceed 18 to 20%.

We therefore recommend that the Department lower the proposed 30% threshold to an amount more in line with the research, possibly 20% for rates calculated using the three year period data and prior three year period data.

Accurately Track Private Loan and Institutional Financing Debt

The regulations at 34 C.F.R. § 668.7(c)(2) define loan debt as including any private educational loans or debt obligations arising from institutional financing plans. This provision could easily be ignored by schools claiming to have no knowledge of these loans. The regulations should require inclusion of private loans that the school knew or should have reasonably known about.

The definition should also be clarified to ensure that all types of private loans and financing are included. This must include a definition of "institutional financing plan", which is not currently defined in the regulations. The definition should be broad enough to include all types of institutional financing, whether closed-end or open-end credit plans.

It is also important to note that all loan amounts reported for program completers, whether federal, private or institutional, are assumed to have the same interest rate as federal unsubsidized loans for the purposes of calculating annual debt service (6.8%). This is considerably less than most private variable rate loans, particularly loans for borrowers with lower credit scores. The private loans we see from our clients often have rates of at least 13 or 14% and in some cases more than 20%.[9] As a result, the use of the unsubsidized federal loan interest rate will significantly understate the debt burden for most private loan borrowers.

Tie the Discretionary Income Standard to Family Size

The discretionary income standard should be tied to family size. The concept of discretionary income recognizes that borrowers with higher incomes can afford to devote a larger

[8] Sandy Baum and Saul Schwartz, "How Much Debt is Too Much? Defining Benchmarks for Manageable Student Debt" (2006).

[9] See generally, National Consumer Law Center, "Paying the Price: The High Cost of Private Student Loans and the Dangers for Student Borrowers" (March 2008), available at: http://www.studentloanborrowerassistance.org/blogs/wp-content/www.studentloanborrowerassistance.org/uploads/File/Report_PrivateLoans.pdf.

share of their income to loan repayment. This makes sense as long as the formula accounts for the higher expenses of those with larger families.

3. Strengthen The Restricted Status Category: 34 C.F.R. 668.7(a)(2) and § 668.7(e)

We are particularly concerned that the restricted status category is no more than a slap on the wrist. We recommend a number of ways to strengthen this category.

Based on the current thresholds, which are too weak as we discuss above, only schools with very poor performance data will fall into a restricted status. Yet the only consequences are required employer affirmations to be provided to the Secretary each year, debt warning disclosures, and limits on the number of enrollees.

At a minimum, we recommend the following changes:

A. **Set a time limit on restricted status.** The lack of a time limit could be a huge crutch for schools that recognize the relatively weak consequences of restricted status. They may choose to continue in this status indefinitely. There should be a time limit of no more than three consecutive years of restricted status. Schools should be able to get out of this status only by showing significant improvement. In addition, repeated periods of restricted status should lead to full ineligibility.

B. **Strengthen the employer affirmations.** The employer affirmation requirement is weak and serves no stated purpose. The regulations at § 668.7(g)(1)(iii) require these schools to provide documentation from employers not affiliated with the institution affirming that the curriculum of the program aligns with recognized occupations at those employers' businesses and that there are projected job vacancies or expected demand for those occupations at those businesses. There is nothing in this provision that requires employers to document whether they would hire or have hired students from the particular school's program. Yet this is the crux of the problem. We repeatedly hear from our clients that potential employers tell them that they never hire students from the proprietary schools they attended. Further, the regulations do not state how this information will be used if at all.

The regulation should also be revised to state that the employer must specify the location of the anticipated job vacancies, as well as the employer's location. The Department should also clarify as to what time period the affirmation should apply.

We also recommend that the Department prescribe the form of the affirmations to be used so that they will be uniform and clear. Among other provisions, the employer should be required to certify that s/he is not affiliated in any way with the school.

C. **Provide specifics for warnings and recognize the limited utility of warnings.** Schools in the provisional category are required to include a prominent warning that is designed and intended to alert prospective and currently enrolled students that they may have difficulty repaying loans obtained for attending that program and disclose the program's most recent loan repayment rate and debt measures. Although we do not object to the provision of warnings, we believe that they are unlikely to have much impact, for a number of reasons. First, disclosures and warnings are generally ineffective. As we have stated repeatedly in the context of consumer credit products and other contexts, no amount of disclosure can adequately protect the public from the failure to underwrite for the basic affordability of loans and in this case for the failure to properly admit or educate students in higher education.

The fiction that disclosures are sufficient to regulate markets and impact consumer decision making is especially apparent for illiterate or barely literate consumers. For example, we recently assisted a client who was pressured into signing up for a proprietary school medical assistant program even though she dropped out of school in ninth grade and had only a sixth grade reading level. She did not complete the course, has never found work in the medical assistant field, has been in and out of homelessness and went into default on the student loans.

Individuals with limited English skills are often exploited as well, including a recent client who signed up for a cosmetology course after being told by a Spanish-speaking school representative that the instructors were bilingual.

Further, this regulation is vague as it does not define "prominent" or even specify what must be disclosed other than that it must be a message designed to alert students about difficulties with loan repayment. This is hardly distinguishable from all of the other disclosures borrowers currently get alerting them to the severe consequences of taking out federal or private loans. Many consumer behavior researchers find that there is an optimism bias that affects most decision making. We may hear the warnings, but assume that they do not apply to us. This is especially true when consumers are also facing hard sell tactics that contradict the message in the disclosures.

D. **Expand the Data Disclosure Requirements.** We support requiring schools in the restricted status category to disclose their actual repayment and debt/income rates. We believe that this requirement, however, should not apply only to schools in this category. <u>All schools should be required to disclose this information.</u> Otherwise, schools have an incentive to get close to the line, but do not have to worry as long as they remain above it. The public as well as prospective students should have access to this information.

The Department requested comment on whether schools with very low rates should be deemed ineligible immediately rather than getting a restricted status. Given all of the weaknesses discussed above with the restricted status, we believe not only that the status should be strengthened, but that schools with very low rates in either the repayment or debt-income categories should not get the benefit of a restricted status.

4. Limit Harm from Ineligible Schools: 34 C.F.R. § 668.7(f)(1)

The Department proposes to allow schools deemed ineligible to continue disbursing funds to students who began attending the program before it became ineligible for the remainder of the award year and for the following award year. This is a recipe for disaster, impacting a large number of borrowers.

Borrowers are already being harmed by attending schools that are not preparing them for gainful employment. The sooner they can get out and if possible move on to stronger schools, the better.

Our clients' experiences illustrate the harm done by prolonging an unproductive, debt-ridden school experience. For example, many of our recent clients attended a local for-profit medical assistant program. These clients did not have high school diplomas or G.E.Ds when they signed up for school. They had numerous complaints about the program. When some of the clients raised concerns, they were told that they might as well try to finish because they were going to have to pay back their loans and the school in any case. Although in fact they could have received partial refunds, the students believed these misrepresentations and stayed in school. They tried to find work after completing, but each was told numerous times by prospective employers that they do not hire individuals without high school diplomas. A few of our clients had asked the school staff at the beginning whether this would be a problem. They were reassured that many graduates without high school diplomas find work in the field. Some of our clients were also told by employers that they never hire graduates from this for-profit school in any case.

These clients are devastated by the time and resources they wasted at this school. Even worse, they are saddled with student loan debts they cannot repay. The most comprehensive remedies, statutory discharges, are available to only a small subset of borrowers suffering harm.

We strongly recommend that the Department stop these programs as soon as possible and provide relief for borrowers. The answer is not to let those schools keep offering those programs, but to ensure that proper relief is provided for the borrowers.

We recommend at a minimum that the regulations be strengthened to provide the following relief:

1. Full loan discharges for any borrower who cannot complete a program due to ineligibility under the gainful employment (GE) process.
2. Full discharges for those who attended a program that lost eligibility due to the GE standard whether the borrowers completed or not as long as they attended within two years of the loss of eligibility.
3. Allow borrowers to raise as a defense to collection that they are in the groups described in #1 or #2 above.

There is authority in current statute and regulations for these types of discharges. The authority for closed school discharges in 20 U.S.C. § 1087(c)(1) states that loans must be canceled if a student is unable to complete the program in which the student is enrolled due to the closure of the institution. This should apply to circumstances in which the borrower's program of study was closed because of ineligibility under the gainful employment standards.

The statute also provides for discharge if the student's eligibility to borrow was falsely certified by the eligible institution. This provision should apply as well since a student would have been falsely certified if the school was not eligible to participate in the federal aid programs due to failure to meet the gainful employment standards. In addition to the statutory discharges, the Department also has general authority to compromise loans.[10] The Department should also seek reimbursement from the schools for discharges granted to borrowers. [11]

Even this level of relief will not be enough for many borrowers. The recommendations above are critical, but in our experience, it will be far from complete because so many borrowers have not only federal loans, but also private loans and institutional debts. We urge the Department to work with other federal agencies to seek solutions for these debt burdens, including supporting bankruptcy relief for these borrowers.

Provide Timely Notice to Students at Schools Deemed Ineligible

The regulation should also specify how borrowers will receive notice when their programs are deemed ineligible. The sooner the borrowers get this information, the better it will be so that they can decide how best to move forward. We recommend that the Department issue notices to borrowers in these circumstances so that the information is standardized and so that the schools do not have the opportunity to soften or otherwise qualify information about impending ineligibility.

We also urge the Department to clarify whether schools may resurrect programs that were ineligible at one time. While it may be reasonable to allow this in certain circumstances, there must be heightened standards for re-starting a program that was previously ineligible.

5. Eliminate the Initial Cap on Ineligible Programs: 34 C.F.R. § 668.7(f)(2)

The Department proposes a transition year during which the number of ineligible programs would be capped. There is a complicated formula proposed to ensure that the programs that are disqualified are the "worst "programs.

The stated reason for limiting the initial disqualifications is to avoid the risk of large and immediate displacement of students. (NPRM p. 43623) We disagree with this reasoning because the borrowers are already being harmed by attending schools that are not preparing them for gainful employment. As discussed above, the sooner they can get out and if possible move on to stronger schools or programs , the better.

Regardless of whether there is a phase-in of this program, there will be borrowers attending programs that will lose eligibility while the students are still enrolled. The answer is not to let those schools keep offering those programs, but to ensure that proper relief is provided for the borrowers, as described above.

6. Limit The Additional Program Requirement: 34 C.F.R. § 668.7(g)

[10] See, e.g., 20 U.S.C. § 1082(a) (FFEL); 31 U.S.C. § 3711 (General authority to compromise government debts); 34 C.F.R. § 30.70.

[11] For example, for discharges granted under the closed school or false certification authority, the regulations provide that after discharge, the borrower is required to cooperate with the Secretary to recover for amounts discharged. 34 C.F.R. § 682.402(e)(4) (false certification).

We agree that there should be a separate standard that at least some schools should have to meet when seeking to offer new programs. However, the proposed standard creates a very low bar. It may be just enough bureaucracy and paperwork to curb innovation by schools with good performance records, but far too little to prevent schools with poor records from meeting the standard.

We recommend that these provisions apply only to institutions with currently restricted programs or with programs determined in the previous three years to be ineligible for federal aid.

7. Streamline the Appeals Process: 34 C.F.R. § 668.90

We agree that schools should be entitled to due process if they face restricted or full ineligibility. However, we are very concerned about possible abuses, especially given the way the cohort default rate (CDR) sanction process has unfolded over time. In the name of "due process", schools have been successful in getting changes enacted in the CDR program that allow a wide range of appeals for reasons ranging from hardship to mitigating circumstances. In addition to watering down the definition of "default rate" over time, the schools used these appeals to take the teeth out of the CDR process. This should be a cautionary lesson.

The hearings should be limited to appeals about problems with the data. The numbers are either accurate or not. Other factors, such as the composition of the student body or limited financial aid staffing resources, should be irrelevant. We also recommend that the Department clarify how an ALJ should consider alternative evidence to the government's data.

It is also essential to ensure that the arbiters of these hearings are trained administrative law judges with demonstrated neutrality, including no ties or connections to proprietary schools. It is critical to devote sufficient resources so that ALJs are available as needed and can hold prompt hearings and issue timely decisions.

Importance of Auditing and Evaluating the GE Standard

Many of our comments focus on the ways in which unscrupulous school operators may attempt to game the system. Based on experiences in the student loan and other industries, the bad actors will be much more creative in coming up with ways to game the system than anyone else. The government simply cannot plan ahead for all possibilities. This is why it is so critical to require reviews and audits of this system to measure whether it is meeting the intended goals. The Department should specifically look for actions that may seem innocuous at first glance, such as pressuring borrowers to get public service loan forgiveness, that are in reality designed to evade the rules. This is difficult because many federal requirements, such as verbal forbearances and "forced consolidations" are in fact the best options for certain borrowers.

Given the possible loss of participation in federal aid programs due to default rate sanctions, schools have started hiring "default management" companies to track down former students and get them into forbearances or other programs that will not impact the school's default rates and help them avoid sanctions.[12] We urge the Department to work with other

[12] See, e.g., Goldie Blumenstyk, "Business is Up in Keeping Default Rates Down", *The Chronicle of Higher Education* (July 11, 2010).

federal agencies to police this emerging industry as we fully expect a branching out into the "gainful employment" area as well.

We are very mindful of the CDR experience. The number of schools facing sanctions in this program diminished substantially over time. The number of schools subject to sanctions peaked in 1994 at 642 and steadily declined so that by 1999, only six schools were subject to sanctions. The highest number of schools sanctioned each year since the millennium is 4 in 2000. [13] This trend was due in part to improvements in default rates. However, the CDR program was also watered down by regulatory and statutory changes in the rate formula and appeals process.

The gainful employment proposal will likely have a strong impact at first because it is making up for years of neglect in terms of agency enforcement. A trend toward lesser sanctions over time is not intrinsically a negative development. Yet it is also not intrinsically a positive development. Looking behind the numbers is essential in creating a system that will remain meaningful over time.

This concern highlights the danger of over-relying on this new system. It must be strong, but even a strong system will never catch all offenders or hold everyone accountable. In coordination with aggressive public and private enforcement and strong relief provisions for borrowers, it can go a long way toward meeting the goals of federal financial aid and encouraging access to real education.

There is a lot of talk about what is best for the clients we represent. We certainly cannot speak for all low-income borrowers, but we have a good sense of what our clients want and need based on our experiences working with them. We strongly believe that our clients deserve more than the illusion of opportunity. They deserve real opportunities to get ahead. Not everyone will succeed, but many more will if this system is put in place.

We thank the Department for its courage and persistence on this issue and for its consideration of our comments.

[13] U.S. Department of Education, "Schools Subject to Sanctions" (2009).

Appendix B

Comments of National Consumer Law Center

on behalf of its low income clients

to

Department Of Education, Office of Postsecondary Education

Negotiated Rulemaking Committee; Public Hearings on

Electronic Disbursement of Higher Education Act Funds

34 CFR Chapter VI

Docket ID ED-2012-OPE-0008

77 Fed. Reg. 25658 (May 1, 2012)

Thank you for the opportunity to submit these comments concerning possible regulatory changes related to disbursement of Title IV, Higher Education Act (HEA) program funds through electronic funds transfers (EFTs) to bank accounts and prepaid cards. These comments are submitted on behalf of our low income clients.

Since 1969, the nonprofit National Consumer Law Center® (NCLC®) has used its expertise in consumer law and energy policy to work for consumer justice and economic security for low-income and other vulnerable people in the United States. NCLC's expertise includes policy analysis and advocacy; consumer law and energy publications; litigation; expert witness services, and training and advice for advocates. NCLC works with nonprofit and legal services organizations, private attorneys, policymakers, and federal and state government and courts across the nation to stop exploitive practices, help financially stressed families build and retain wealth, and advance economic fairness. NCLC publishes a series of consumer law treatises, including Consumer Banking and Payments Law and Student Loan Law.

Summary

We support efforts to reduce fraud and increase efficiency in disbursement of HEA funds through greater use of EFTs in lieu of checks. However, students should have a greater role in deciding where to bank and what type of account to have to manage their financial affairs. In addition, both the Department of Education and schools must undertake greater efforts to ensure that contracts entered into with financial institutions do not impose unnecessary fees, risks or inconveniences on students.

The education that a student receives in college is more than what takes place in the classroom. For many, college is the first time that students have lived on their own and handled their own financial affairs. Others are balancing reduced income and school. Encouraging students to make wise financial choices and to learn how to manage a financial account is essential.

Schools should not skew the choices that a student can make – or, worse, make bad choices for them – by choosing the institution that provides the most revenue to the school. Financial services

that are provided through a contract selected by the school can provide convenience and other benefits to students. But the conflict of interest that the school faces in choosing who to contract with, the terms of the contract, and the way in which the choice is presented to students are just too great when the school is influenced by the amount of revenue it receives.

The Department should ban schools from receiving revenue from accounts used to disburse HEA funds. The Department, together with the Consumer Financial Protection Bureau and schools, should also ensure that:

- Direct deposit to an account of the student's own choosing is always an early first choice, with a check as an option, and students are able to exercise that choice easily and without impediments or delay in receiving funds.
- Students are clearly and conspicuously informed that they can decline a bank or prepaid account arranged by the school, and can transfer any money into their own account easily and without charge.
- Any bank or prepaid card account arranged by the school:
  - Has sufficient free ATM access;
  - Does not carry any overdraft fees or any other credit features;
  - Provides ample free access to account information, including customer service, balances, statements and transaction histories;
  - Does not carry any unnecessary or excessive fees, including fees to access student aid money;
  - Complies fully with Regulation E and carries FDIC or NCUSIF insurance on a pass-through basis to the student;
  - Has terms that are clearly and conspicuously disclosed to the student in all solicitations, mailers and other communications before the student decides to accept the account.

I. Students Should Be Able to Choose Where to Bank

College students, like other adults, have the right to choose how to handle their financial affairs. Learning to do so is just as much a part of their education as the material taught in classrooms. Indeed, financial management may be one of the subjects taught by the school.

An increasing number of schools are steering students into using cards selected by the school to hold their financial aid money and other funds that cover expenses while in school.[1] There are a variety of models, some involving a prepaid card, some a checking account, and some fall somewhere in between.

In some cases, the school encourages students to link their student ID card to a prepaid card account that has the same limitations of many prepaid cards: no checks, limited access to a full service financial institution, and fees for a variety of everyday services such as depositing checks, getting cash

[1] These comments are addressed to cards that hold unrestricted funds, not closed-loop cards that hold funds restricted to a particular use, such as a meal plan, laundry or books.

and checking one's balance at an ATM.[2] While prepaid cards can be useful for individuals who are unable to get bank accounts or have had difficulty managing them, most students do not fall into those categories. Banks are typically eager to sign up students, and students starting college do not usually have a checkered history that would prevent them from getting a bank account. Older students (and many younger students) likely have existing accounts. Though students are a diverse group and many are lower income, there is no evidence that schools are turning to prepaid cards due to student difficulties in receiving funds.

Some accounts offered to students purport to be checking accounts but are really hybrids that in many ways are more like prepaid cards. The Higher One "OneAccount," for example, does not come with a bank branch network or a significant network of free ATMs. Off campus, most ATM withdrawals will cost $2.50 plus any surcharge from the ATM owner. Students will incur a 3.5% fee (i.e., $17.50 for a $500 withdrawal) to withdraw cash from a bank teller (if, for example, the student needs more than an ATM will dispense). Students cannot use ATMs or bank branches to deposit checks and may have to pay a $4.95 fee just to make a deposit.[3] That fee is not even disclosed on the fee schedule because it is a fee charged by a separate company for purchasing the MoneyPak that must be used.[4] The limitations on the account are not readily apparent from the company's website.

Some schools have contracts to provide a bank account, not a prepaid card, to students. But even then, the student should be encouraged to choose the bank that is right for them. The same goes for prepaid cards: even if the student prefers a prepaid card over a bank account for some reason, there are many prepaid cards on the market and the student might prefer a different one.

Whether a student chooses to have a bank account or a prepaid card, the right choice may not be the one that has the school contract. The student may prefer an account that:

- Has a broader free ATM network, not only around the school but also in the student's home or target career city.
- Has lower fees, as smaller banks typically do.
- Has branches in the student's home state, or is where parents bank.
- Does not encourage overdraft fees or overspending.
- Has more sophisticated mobile apps and internet banking functions.
- Offers text alerts or other tools for responsible financial management.
- Is not offered by an institution that the student finds objectionable.
- Is a smaller, community based institution with more personal service.

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[2] American Express, for example, does not have a free ATM network.
[3] The $4.95 fee is the cost of purchasing a MoneyPak used to reload the card. It is not clear if any fee is charged if the student uses their smartphone to take a picture of a check and deposit it remotely. But not all students have smartphones or are aware of or comfortable with remote deposit capture.
[4] The fee can only be seen by under the "new features" icon at http://www.higherone.com/index.php?option=com_content&view=article&id=44&Itemid=82. Higher One will reimburse the fee for the first purchase. The fee schedule lists: "Add Money to the OneAccount: No additional fee." But clicking on that item reveals that the reference is only to transfers from a third party bank account, and even then the sender may incur a fee from their own bank.

Overdraft fees, in particular, are a real problem for young adults, and some banks are better than others. For years, many banks silently added a hidden line of credit on their debit cards so that ATM withdrawals or purchases would be approved when the account had insufficient funds. A miscalculation as low as $1 could trigger a $35 overdraft fee on a purchase that the student would prefer be denied.

Young adults, often students, paid $1.3 billion in overdraft fees in 2008.[5] Because they are more likely to use a debit card for small transactions than older adults, they were paying $3 in fees for every $1 borrowed on a debit card when the national average was $2 in fees for every $1 borrowed.[6] An FDIC Survey found that young adults were the most likely to overdraw their accounts, with 46 percent of all young adults overdrawing their accounts in the previous year.[7]

Though new federal rules have curbed some overdraft fee abuses, the fees are still a significant problem. A recent study found that 17 percent of consumers ages 18 to 24 incurred overdraft fees, a rate nearly twice as high as consumers 44 and over.[8] Some banks engage in aggressive and sometimes misleading marketing to induce consumers to opt in to overdraft "protection" on ATM and debit card transactions, when in reality they are just opting in to overdraft fees.[9] One survey found that sixty percent (60%) of consumers who opted in to overdraft coverage did so to avoid a fee if their debit card was declined – when opting in had the exact opposite effect.[10] Some banks also manipulate the order in which transactions are posted in order to increase the number of overdraft fees that are triggered.

Banks differ considerably in whether they still engage in methods to induce consumers into incurring overdraft fees or help consumers avoid spending more than they have. Citibank, for example, has never charged overdraft fees on ATM or debit card transactions, HSBC now does not, and Bank of America does not for debit card transactions. For check and electronic payments, some banks

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[5] Leslie Parrish and Peter Smith, *Billion Dollar Deal: Banks swipe fees as young adults swipe debit cards, colleges play along*, Center for Responsible Lending, at 1 (Sept. 24, 2007) [hereinafter *Billion Dollar Deal*], *available at* http://www.responsiblelending.org/overdraft-loans/research-analysis/billion-dollar-deal.pdf.

[6] According to a 2006 survey, seven out of ten young adults would use a debit card for purchases costing less than $2. *Billion Dollar Deal* at 3.

[7] FDIC Overdraft Study, 2008, at v.

[8] Pew Center on the States, "Overdraft America: Confusion and Concerns about Bank Practices" (May 2012), available at http://www.pewtrusts.org/uploadedFiles/wwwpewtrustsorg/Fact_Sheets/Safe_Checking/Overdraft_America_Final.pdf.

[9] For further discussion and examples of this targeting strategy, see Leslie Parrish, Banks Target, Mislead Consumers As Overdraft Deadline Nears, Center for Responsible Lending (August 5, 2010), available at http://www.responsiblelending.org/overdraft-loans/research-analysis/Banks-Target-And-Mislead-Consumers-As-Overdraft-Dateline-Nears.pdf. *See also* Center for Responsible Lending Research Brief, Banks Collect Opt-Ins Through Misleading Marketing, April 2011, available at http://www.responsiblelending.org/overdraft-loans/policy-legislation/regulators/banks-misleading-marketing.html .

[10] *Id.* Pew Center on the States, "Overdraft America: Confusion and Concerns about Bank Practices" (May 2012), available at http://www.pewtrusts.org/uploadedFiles/wwwpewtrustsorg/Fact_Sheets/Safe_Checking/Overdraft_America_Final.pdf.

encourage consumers to use better options for overdraft protection, such as transfers from linked savings or credit cards or reasonably priced, amortizing overdraft lines of credit.

On the other hand, Wells Fargo and U.S. Bank – two banks with large numbers of contracts with schools – offer opt-in overdrafts on ATM and debit card transactions. Many other banks do as well. Though most prepaid cards do not have overdraft fees, some do, typically following the Regulation E opt-in rules.

Beyond overdraft fees, Wells Fargo and U.S. Bank are also among a very small number of banks that offer extremely expensive, triple-digit "account advance" payday loans as a means of covering shortfalls. The banks will advance funds before a consumer's regular direct deposit arrives for a fee that can be comparable to 274% to 365% APR or higher.[11] Just like regular payday loans, bank payday loans can lead to a cycle of debt and repeat borrowing.[12] It is unclear if the banks are making these payday loans available on student accounts, but we have no indication that they are not.

Most students would be better off at a bank that did not provide tools that encouraged overspending and the accumulation of fees. Students should be able to make that choice without being steered to the bank that has a revenue sharing contract with the school.

II. Schools Should Not Manipulate the Students' Choice and May Be Skirting Federal Law if They Do So

As described in greater length in the comments of U.S. PIRG and its recent report on college card programs, schools and the financial institutions with which they partner have sometimes gone to great lengths to push students into using the institution that has a revenue-sharing contract with the school. They may require the student to use a particular account to receive financial aid funds, may obscure the student's choice or make it difficult to exercise that choice.

Schools that require students to have an account at a particular bank or prepaid card provider may be violating federal law, both in letter and in spirit. The Electronic Funds Transfer Act, and its implementing Regulation E, provide:

> No person may … require a consumer to establish an account for receipt of electronic fund transfers with a particular financial institution as a condition of employment or receipt of a government benefit.[13]

Financial aid from the federal, state or local government, including a public school, is a government benefit.

This EFTA rule is violated if the student is defaulted into a particular account, even if the student can disenroll.[14] Similarly, even if the student is able to transfer their money out of the account, they are

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[11] *See* National Consumer Law Center, "300% Bank Payday Loans Spreading" (April 2011), available at http://www.nclc.org/images/pdf/banking_and_payment_systems/ib_bank_payday_spreading.pdf.
[12] *See* Center for Responsible Lending, "High-interest loans through checking accounts keep customers in long-term debt," http://www.responsiblelending.org/payday-lending/research-analysis/big-bank-payday-loans.html.
[13] 15 U.S.C. § 1693k(2); *see* Regulation E, 12 C.F.R. § 205.10(e).

still required to have the account in the first place, and must suffer a delay in receiving their funds to make the transfer.

Another EFTA provision also bolsters the importance of consumer choice. A financial institution is not permitted to send the consumer an unsolicited access device, such as a debit or prepaid card, except under limited circumstances. The card cannot be sent validated, and may be validated only later "in response to a request or application from the consumer."[15] The card must also be "accompanied by a clear explanation ... that such card ... is not validated and how the consumer may dispose of such [card] if validation is not desired."[16]

Department of Education rules similarly mandate that students must have the choice of how to receive their funds. If an educational institution opens a bank or prepaid card account on behalf of a student or parent, it must, among other requirements, "obtain in writing affirmative consent from the student or parent to open that account."[17] All information required for an authorization "must be conspicuous."[18] The Department has made clear that "a school may not require or coerce the student or parent to provide an authorization …."[19]

The rules are clear, but the Department's sample form for authorizing consent is not and should be revised. Although the form indicates that the student can withhold agreement, it does not explain the student's other choices, encourage the student to exercise them, or promise that choosing another option will not result in delay. Instead of being styled as an authorization, just one in a stack of paperwork that the student must sign, the form should be reworked into an election form, asking the student to choose how to disburse funds, with direct deposit to the consumer's own account as the clear first option.

A student can only give affirmative consent if it is clear that the student has a choice and can freely choose another method of receiving funds without being disadvantaged. However, some school-selected providers are apparently manipulating that choice. Some programs send unsolicited cards to students and lead the student into believing that they *must* activate the card. Providers may also push students into choosing their account by emphasizing faster access to their money.

These pressure tactics should not be tolerated. The school can determine the student's choice ahead of time and can easily arrange for payment by alternative methods without delay. Students should not be pushed into choosing an account that they may have for years to come based solely on getting their first check two or three days earlier.

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[14] *Cf.* Pinkett v. First Citizens Bank, 2010 WL 1910520 (N.D. Ill. May 10, 2010) (interpreting related ban on credit conditioned on preauthorized electronic fund transfer).
[15] 15 U.S.C. § 1693i(b)(4); *see* Regulation E, 12 C.F.R. § 205.5(b).
[16] 15 U.S.C. § 1693i(b)(3); *see* Regulation E, 12 C.F.R. § 205.5(b)(2).
[17] 34 C.F.R. § 668.14(c)(3)(i).
[18] FSA Handbook at 4-27.
[19] FSA Handbook at 4-6.

III. Rules for Accounts that Schools Open on Behalf of Students

When students do choose to use a bank or prepaid card account provided under a contract with the school, the school has a special obligation to ensure that the account is safe and appropriate for the student. Students will logically assume that the school has endorsed the program. Many students will use the bank or prepaid card program without careful study or comparing other options. Whenever a school lends it imprimatur and access to its students to a program, and especially if the school is getting revenue and has a conflict of interest, it must go above and beyond to ensure that the account is safe and appropriate for students.

A. Accounts Must Be Safe: Insured, Regulation E Compliant, No Overdraft Fees or Credit Features

At the most basic level, bank or prepaid card accounts provided under school contracts must be safe.

1. Deposit Insurance

First, the funds must be protected in the case of insolvency of the bank or any other party involved with the program. Insurance from the Federal Deposit Insurance Corporation (FDIC) or the National Credit Union Share Insurance Fund (NCUSIF) should be required.[20] Indeed, under Treasury Department rules, federal payments may not be made to a prepaid card account that does not carry FDIC or NCSIF insurance.[21] Department of Education rules also require deposit insurance for any prepaid card account used to make direct payments to students such as credit balances and work study funds.[22]

However, it is not clear that all schools are following this requirement. One provider of prepaid card services to schools, American Express, does not store its funds in a bank and is not eligible for FDIC or NCSIF insurance. The fine print of the terms and conditions on the American Express Prepaid Card for Student IDs acknowledge: "Funds on the Card are not FDIC-insured …."[23] It is not clear what types of funds are eligible to be deposited onto the prepaid card or whether Department rules apply.

Bank or credit union accounts always carry deposit insurance. Prepaid cards are eligible for deposit insurance if the funds are held in a bank or credit union and follow FDIC or NCUSIF rules for

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[20] A beneficial side effect of compliance with the FDIC's pass-through insurance rules for prepaid card accounts is that it creates a custodial relationship with the bank, which should protect the student's access to the funds even if another party involved with the card, other than the bank, should become insolvent.

[21] *See* 31 C.F.R. § 210.5(b)(5)(i).

[22] 34 C.F.R. § 668.164(c)(2); U.S. Dep't of Education, Federal Student Aid Handbook, 2012-13, at 4-24, available at http://ifap.ed.gov/ifap/byAwardYear.jsp?type=fsahandbook.

[23] *See* https://www212.americanexpress.com/dsmlive/dsm/dom/us/en/personal/cardmember/additionalproductsandservices/giftcardsandtravelerscheques/studentid_cardmember.do?vgnextoid=51185ee79e061310VgnVCM40000037b3ad94RCRD&vgnextchannel=95ddb81e8482a110VgnVCM100000defaad94RCRD&appInstanceName=default&vgnextnoice=1&name=studentid_cardmember&type=intbenefitdetail.

deposit insurance. Most do, but there is no guarantee and the student has no way of knowing. The Department should reiterate this rule and examine schools to make sure they are in compliance.

2. Protection Against Loss, Theft, Unauthorized Transfers and Errors

Accounts used for student funds should comply with the EFTA and Regulation E, which provide protections against loss, theft, unauthorized transfers and errors. Regulation E already applies to bank accounts and to certain prepaid cards, and others typically comply voluntarily. Nonetheless, the student has no way of knowing and Regulation E compliance should be required.

Treasury rules require Regulation E compliance on prepaid card accounts that receive federal payments.[24] It does not appear that Department of Education rules address Regulation E, but they should. The CFPB should also extend Regulation E more fully to all prepaid cards to avoid any uncertainty.

3. No Overdraft Fees or Credit Features

Third, bank accounts and prepaid cards should be free of overdraft fees and credit features. Students who are just learning how to manage their finances, or struggling with reduced income, should not be subject to dangerous pitfalls. As discussed above, overdraft fees have been very problematic for many students.

Here again, Treasury rules prohibit federal payments to a prepaid card that has a line of credit or loan agreement that is repaid automatically upon deposit of the federal payments.[25] Overdraft fee programs are a form of loan that is repaid automatically upon deposit and should not be permitted on such cards. But it is not clear that all cards comply. Overdraft fees should also be banned on school accounts that receive funds other than federal payments.

Department of Education rules are consistent with the Treasury rules. If a school opens a bank or prepaid card account for a student, it cannot "subsequently convert the account, card, or device to a credit card or credit instrument."[26]

Debit cards that trigger overdraft fees or can access an account advance line of credit are a "credit instrument."[27] Such features permit the student to borrow funds, use the debit card for purchases, and repay the funds later. The Department should make clear to schools that overdraft fees and credit features are prohibited on school-selected accounts.

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[24] *See* 31 C.F.R. § 210.5(b)(5)(i).
[25] *See* 31 C.F.R. § 210.5(b)(5)(i). The Treasury direct deposit rules do not apply to individual bank accounts.
[26] 34 C.F.R. § 668.164(c)(3)(vii).
[27] The Truth in Lending Act defines "credit" as "the right granted by a creditor to a debtor to defer payment of a debt or to incur debt and defer its payment." 15 U.S.C. § 1602(e). Joint guidance by several federal banking regulators acknowledged that "[w]hen overdrafts are paid, credit is extended" and "[o]verdraft balances should be reported on regulatory reports as loans." 70 Fed. Reg. 9127, 9129 (Feb. 24, 2005). For a longer discussion of why overdraft is credit, see National Consumer Law Center, Truth in Lending § 2.5.7.2 (7th ed. 2010 and Supp.).

Congress has also expressed its view that prepaid cards should not have overdraft fees. Overdraft fees are banned on prepaid cards as a condition of their exemption from a cap on interchange fees charged to merchants.[28] However, that ban only applies to cards issued by banks over $10 billion, as smaller banks are not subject to the interchange fee cap.

While school prepaid card programs do not typically have any credit features, bank accounts may. Students may be able to opt in to overdraft "coverage" that will convert the debit card into a credit instrument and permit purchases and ATM withdraw even if the account has insufficient funds, triggering a hefty overdraft fee. Studies have shown that most consumers would prefer that the purchase be denied instead,[29] but banks often manipulate consumers into opting into overdraft fees unwittingly.[30]

If a school is picking an account for its students, it should ensure that it does not have credit features that can get a student in trouble. The Department should clarify that overdraft fees triggered by ATM or debit card transactions, and account advance payday loans, are prohibited on any school-selected bank or prepaid card account. For accounts that offer checks and electronic payments, which cannot be so easily denied at point-of-sale as a debit card transaction, the Department should require schools to use a provider that encourages links to safer and more affordable options for covering overdrafts (such as links to a savings account).

B. Accounts Must Offer Ample Free ATM Access and Free Transfers to Other Accounts

The Department already has a rule that emphasize that students may not be charged for receiving FSA funds. In order to make that rule a reality for students who select the school-sponsored account, the Department should require a certain number of free ATMs near the school. Any school-provided account should also offer at least one free transfer per deposit to the consumer's own account.

C. Students Must Have Ample Free Access to Account Information: Balances, Statements, Transaction Information, Customer Service

Students need ample, free and convenient access to account information and customer service. They should have multiple free methods of determining their balances, getting statements and transaction information, asking questions and resolving issues with their accounts. That information is essential to sound financial management.

[28] 15 U.S.C. § 1693o-2(a)(7)(B) (effective July 21, 2012).

[29] Pew Center on the States, "Overdraft America: Confusion and Concerns about Bank Practices" (May 2012), available at http://www.pewtrusts.org/uploadedFiles/wwwpewtrustsorg/Fact_Sheets/Safe_Checking/Overdraft_America_Final.pdf; Center for Responsible Lending Research Brief, Banks Collect Opt-Ins Through Misleading Marketing, April 2011, available at http://www.responsiblelending.org/overdraft-loans/policy-legislation/regulators/banks-misleading-marketing.html .

[30] *Id.*

Accessing account information is normally not an issue with a traditional bank account, but it can be more expensive and restricted on prepaid cards. Consumers are not encouraged to view the cards as "accounts" and do not receive paper statements. They are expected to remember to monitor their accounts online, may not even receive emails when electronic statements are available, and may be charged high fees if they prefer paper statements.[31] Most prepaid cards are not provided through brick-and-mortar locations that offer access to a human being. Fees may be charged for telephone customer service, and the consumer must enter long strings of numbers and navigate multiple menus to get to a live agent. Fees may even be charged for simple balance inquiries at ATMs or accessing an automated customer service line.

Prepaid cards should not be a black box in the students' wallet. They are accounts, and consumers should be able, and encouraged, to monitor their accounts for fees, errors and unauthorized charges. Students unfamiliar with prepaid cards may have questions about how the cards work. Like any consumer, they need the ability to resolve the problems that can arise. Students should not be nickeled and dimed for seeking the information they need, or worse, be inhibited from doing so.

D. Accounts Must Be Free of Problematic or Excessive Fees

If a school is picking an account for the student, it has a special obligation to make sure that the account is free of problematic or excessive fees. Problematic fees fall into different categories.

- *Overdraft fees.* Any account chosen for a student should not permit overdrafts or overdraft fees, for the reasons discussed above.
- *Usage fees.* Fees for ATM withdrawals, depositing checks, and other everyday activities can add up on prepaid cards for services that are normally free with bank accounts. Schools must consider the multiple ways in which students are expected to use a financial account and select accounts that minimize extra charges.
- *Information fees.* Students should not be charged fees for checking their balance, calling customer service, or accessing account information. Paper statements should be free with a bank account and available for no more than $1 per month for prepaid cards. Information is critical to managing an account.
- *Fees for exercising legal rights*. Consumers have the right to stop payment on checks and preauthorized electronic transfers, to dispute unauthorized charges, and to exercise other protections. Exercising those rights can come with hefty fees that should not be permitted.
- *Inactivity fees, account closure and check issuance fees.* Some student accounts start incurring inactivity fees after less than a year of inactivity, and the fees can as high as $12 per month. The account may even charge the student for refunding the balance and closing the account. If an account is inactive, the student should be notified that the account will be closed if it is unwanted and then all money should be refunded without charge.

[31] Many students will prefer electronic statements, but students should be encouraged to use whatever method works for them to monitor their accounts. Some will find that they are more likely to remember to look at their statement when it comes in the mail, when they can open it without remembering an account number or password and without needing to spend time on the computer. Monitoring accounts for unauthorized charges and unwanted fees is just too important to limit student options for doing so.

The Department should issue rules to schools on what types of fees are permitted on accounts selected by a school. For example, the Department of Labor issued guidance to states in connection with prepaid card programs used to pay unemployment compensation.[32] It is important that rules be clear. A report we issued shows that not all states are following the Department of Labor's guidance and that many cards charge inappropriate fees.[33] That report also includes a longer discussion about the issues surrounding particular fees.

E. Fees, Account Terms and ATM Access Must be Clearly and Conspicuously Disclosed

It is axiomatic that students need clear information about the terms of an account if they are to make an informed choice about whether to use it. That information is often sorely lacking. Fee schedules may be provided, but they may be buried in complicated terms and conditions and packed with misleading representations about what is free and what is not.

The size of the free ATM network is a significant factor in how much an account will cost a student, and how convenient it will be, yet that information is not readily available. Accounts that are offered through schools should be required to provide maps showing the location of free ATMs near the school and a list of the free ATMs available state-by-state.

Students also need more clear and conspicuous information about other important factors, such as limitations on how and whether funds can be deposited into an account (i.e., checks) and the various ways in which they can get statements or transaction information.

Students who are simply trying to access their financial aid money, not shopping for a new account, may be pressured into clicking into a new account without fully considering the costs and features of the account. Students should be advised *ahead of time* about their options for how to receive their aid money and the full costs, terms and features of any account offered by the school. It should not be a rushed decision the moment the money arrives.

III. Recommendations

1. *Encourage and facilitate direct deposit.* The Department of Education should develop rules to ensure that students are offered the clear and easy choice of direct deposit to an account of their own choosing, or a paper check, before they are given a school-selected account. Those rules should require the information to be present in a *clear, unbiased* manner, *early*, before financial aid money arrives, and permit the student to exercise their choice *easily*, through electronic methods and not merely by faxing a cumbersome paper form. The Department should revise and develop new forms to

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[32] *See* Employment and Training Admin'n Advisory System, U.S. Dep't of Labor, Unemployment Insurance Program Letter No. 34-09 on Best Practices for Payment of Unemployment Compensation by Debit Cards, at 3 (Aug. 21, 2009), available at http://wdr.doleta.gov/directives/corr_doc.cfm?DOCN=2795.

[33] *See* National Consumer Law Center, Unemployment Compensation Prepaid Cards: States Can Deal Workers a Winning Hand by Discarding Junk Fees (May 2011), available at http://www.nclc.org/issues/unemployment-compensation-prepaid-cards.html.

facilitate this process (as on tax returns) and to ensure that exercising choice does not delay receipt of funds.

2. *Ban revenue sharing.* Schools have too much of a conflict of interest in selecting a provider and setting the terms when they receive revenue when students use a particular account. Schools' revenue considerations should not skew the student's financial management.

3. *Ensure sufficient free access to cash.* The Department of Education should develop more detailed guidelines for accounts that schools offer to students to ensure that students can access their funds without charge. The rule requiring that students have "convenient access"[34] to ATMs should specify a certain number of ATMs based on the size of the student body and of the campus. One free transfer per deposit to another account should be required so that students who accept the school account out of inertia or misunderstanding can easily transfer off their money.

4. *Promulgate rules on the fees that may be charged on school-selected accounts.* The school has a strong influence on what account students will select. The Department should issue rules that clearly ban overdraft and information fees and limit other types of fees that may be charged.

5. *Improve information.* The Department of Education should require schools to provide students clearer information about the fees, ATM networks (with a map of local locations), features and limitations of the accounts they sponsor. That information should be provided well ahead of time, so that students can consider it and decide if they want to use that account or a different one.

IV. Conclusion

Schools have a special obligation when inserting themselves into the student's choice of how to manage their financial affairs. Schools have undue influence, and the account that a student may choose affects them not only while in school but may stay with the student for years to come. Students need to learn how to choose a financial account that minimizes expenses and facilitates budgeting and financial management. The Department needs to do more to ensure that revenue considerations are not driving schools to interfere with this important part of the student's education.

[34] 34 C.F.R. § 668.164(c)(3).