

## DOCKET ID ED-2007-OPE-0133

Comments to the Department of Education on Federal Student Aid Program Proposed Regulations  
(Submitted August 9, 2007)

### Introduction

The National Consumer Law Center (NCLC)<sup>1</sup> submits the following comments on behalf of its low-income clients as well as the United States Public Interest Research Group (U.S. PIRG)<sup>2</sup> and the United States Student Association.<sup>3</sup> These comments are submitted in response to the Department of Education's student aid program proposed regulations, published on June 12, 2007 (72 Fed. Reg. 32410).

#### I. Disability Discharge

**Comment: We oppose the Department's disability discharge proposals. The proposed changes fail to fix a broken process. Instead of making the process work better for truly disabled borrowers, the Department has once again overreacted to exaggerated reports of abuse and made the system even more inaccessible for needy borrowers.**

The proposals fail to address the most serious problems with the disability discharge system, which include:

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<sup>1</sup> The National Consumer Law Center, Inc. is a nonprofit Massachusetts corporation, founded in 1969, specializing in consumer issues, with an emphasis on consumer credit. On a daily basis, 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), as well as bimonthly newsletters on a range of topics related to consumer credit issues and low-income consumers. These comments were written by Deanne Loonin.

<sup>2</sup> U.S. PIRG is a national network of non-profit, non-partisan public interest advocacy groups. The Higher Education Project was established in 1994 to secure more aid for students, with a focus on additional grants, reduced debt, and better service to students in the federal financial aid system.

<sup>3</sup> The United States Student Association (USSA) is the country's oldest and largest national student organization, representing millions of students across the country. Founded in 1947, USSA is the recognized voice for students on Capitol Hill, in the White House and the Department of Education.

- a. **An arbitrary medical review system.** The Department routinely requests additional information from physicians who have already signed discharge forms, often giving these doctors unrealistic time tables to respond (such as three days). As a result, many qualified borrowers with very serious disabilities are denied discharges based on “medical review failures.” It is difficult for many doctors to discern what is expected of them. In many cases, doctors are repeatedly asked for the same information.
- b. **The failure to accept Social Security or other federal agency disability determinations as evidence of disability.** Although Congress and the Department have not tied the definition of disability to the standards used by other agencies, there is no reason why the Department could not consider decisions made by other federal agencies. Among other advantages, other federal agencies, such as Social Security, actually have medical staff examining patients and making medically-based decisions.
- c. **Applications are improperly denied because the borrower is working or has worked in the past.** The Department has made it clear that a borrower cannot be earning income at the time the doctor certifies a total and permanent disability. However, limited earnings are allowed during the conditional discharge period. This is critical in order to encourage borrower attempts at rehabilitation. Many borrowers attempt work, make limited earnings, but quickly discover that they can no longer work. Flat denials of these borrowers’ applications for discharge are wrong.
- d. **The Department disqualifies borrowers who take out new federal student loans during the conditional discharge period.** Although taking out a new government student loan will disqualify a borrower during the conditional discharge period, the definition of permanent and total disability does not prohibit school attendance. Considering loans in addition to earnings inhibits borrower efforts at rehabilitation through education.
- e. **There is no time limit placed on the Department to make determinations once applications are assigned to them.** This is especially serious, as discussed below, now that the Department is proposing to hold off the start date of the conditional discharge period until it has made a determination on a disability discharge application.

None of these critical issues is addressed in the proposed regulations. Instead, the Department has further diluted the borrower’s statutory right to a disability discharge. The statute at 20 U.S.C. §1087(a) is called “Repayment in Full for Death and Disability.” It provides that if a borrower becomes totally and permanently disabled, the Secretary shall discharge the borrower’s liability on the loan by repaying the amount owed on the loan.

As described in detail below, the proposed regulations violate the statutory authority in a number of ways, primarily by a) eliminating eligible borrowers' current right to full repayment from the date of disability, b) setting an arbitrary date to begin the conditional discharge period, and c) by making a confusing process even more confusing and an inefficient process potentially even more inefficient.

#### **A. Starting the Conditional Discharge Period From the Department's Determination Date is Arbitrary and Unfair to Borrowers**

The key change in the proposed rules is to create a prospective conditional discharge period. The period will begin to run from the date the Secretary determines that a borrower is disabled.

We did not object at the negotiating table nor do we object now to some consideration of the borrower's current situation when making a disability discharge determination. The Inspector General (IG) in a 2005 report noted this concern and recommended that the Department consider a borrower's current information.<sup>4</sup>

However, we object to the way in which the Department has addressed this issue. The Department could have chosen to consider current information in a variety of ways that would have preserved essential borrower rights. For example, the Department could have added an additional one year prospective period to the retroactive period or otherwise reviewed the borrower's current earnings for a limited period of time.

#### **The Alleged Evidence of Fraud Is Exaggerated**

The Department has overreacted in its attempt to weed out alleged fraud in the program. Presumably this reaction was largely in response to the 2005 IG report. In a limited study of about 2,500 borrowers, the IG found that about 54% of borrowers who had obtained disability discharges filed applications more than three years after their reported disability dates.

The mere fact that certain borrowers received retroactive discharges, however, does not prove that there were problems with these discharges. Unfortunately, the IG did not dig much deeper. The IG acknowledged that it did not identify whether these borrowers would have been ineligible for a disability discharge if the discharge were based on their current earnings.<sup>5</sup> They were able to evaluate this issue for only 121 of the more than 2,500 borrowers in the study (about 4.6%). Of these 121 borrowers, 10 (or about 8%) reported income over the allowable regulatory limits. This is hardly a significant statistical basis or sample size to prove anything.

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<sup>4</sup> U.S. Department of Education, Office of Inspector General, "Final Audit Report: Death and Total and Permanent Disability Discharges of FFEL and Direct Loan Program Loans" Control Number Ed-OIG/A04E0006 (November 14, 2005).

<sup>5</sup> Id. at 6.

The Department's negotiators did not provide additional evidence of "abuses" during the negotiating sessions. The Department merely notes in the preamble that "...there have been instances when borrowers have received otherwise disqualifying Title IV loans and earnings in excess of allowable levels after the date of application but also after the date of the borrower's retroactive final discharge."<sup>6</sup> There have also been countless instances of severely disabled borrowers receiving denials, yet the Department does not address this problem.

The most thorough evidence on this issue came from a negotiator representing guaranty agencies, Great Lakes Higher Education Guaranty Corporation. The agency found no evidence of a relevant number of disability discharge applicants who subsequently obtained new loans after getting a discharge. Further, the guarantor's sampling failed to identify even a single instance in which a borrower had obtained a final discharge and then obtained a new loan. Those applications that were rejected were generally due to medical review failure.

**The decision to use the physician's certification date as the initial date of disability and to begin the conditional discharge period on the date of the Department's determination is completely arbitrary.**

Few borrowers have any idea that they have a right to a disability discharge. Those that do still may not apply right away as the primary concern of borrowers and families faced with severe disabilities is rarely the status of Title IV loan debts. Utilizing the physician's certification date rather than the onset of the disability as the trigger for discharge effectively denies the statutory relief authorized in the Higher Education Act.

One reason cited by the Department for eliminating consideration of the doctor-determined disability onset date is that doctors may not have the right date. Once again, there is no evidence to support this concern. The Department simply states in the preamble that in their experience doctors have to rely on borrower statements and are likely to set earlier onset dates based on these reports.<sup>7</sup> This issue was not even mentioned in the IG report, presumably because the IG knew that they could not and did not make any effort to actually survey and track doctors. In contrast, our experience with our disabled clients over the years is that doctors often will use the current date if they do not have a long history with the patient.

In any case, the medical review process is supposed to evaluate the doctor's determination. We do not believe that Congress intends for the Department to generally assume that the physician's diagnostic methodology is flawed and thus override the physician's expertise and create an arbitrary date on which to base eligibility.

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<sup>6</sup> 72 Fed. Reg. 32410, 32414 (June 12, 2007).

<sup>7</sup> Id.

## **B. There is No Basis for Denying a Borrower's Right to A Refund From the Date of Disability**

If a borrower successfully obtains a final disability discharge, the proposed rules allow refund of payments made only back to date the doctor completed and certified the discharge application. In contrast, under the current regulations, borrowers are refunded any payments made from the disability onset date. Negotiators at the table unanimously opposed the Department's proposal on this issue.

This is particularly troublesome because prior to issuing these proposed rules, neither the Department nor the IG has publicly indicated that there were problems with the administrative process that returned payments made by eligible borrowers from the disability onset date.

To illustrate the unfairness of this proposal, consider the following example. Ms. B is 70 years old. She took out a PLUS loan when she was in her 50's to help finance her son's education. At the time, she was employed as a janitor at a local school. She suffered a severe stroke when she was 60 years old and has been unable to work since then. For a while, she was still able to make payments on her student loan, but ultimately defaulted due to the extreme decline in her income after her illness. She has no assets and her only income is from Social Security payments. The Department began offsetting those payments in 2000. Ms. B. had no idea that she could apply for a disability discharge of her loan. The collection letters she received from a private collection agency certainly did not discuss her rights. She does not use the Internet and has trouble reading in any case due to her condition. Since 2003, she has been living in a nursing facility. Another son ultimately sought assistance for his mother from a local legal aid office in 2005. The legal aid attorney assisted Ms. B. in applying for a disability discharge. Her doctor was easily able to pinpoint the disability onset date since it occurred ten years ago when Ms. B suffered her stroke. The conditional discharge period was over by the time Ms. B applied for the discharge and she received refunds of the amounts offset from her Social Security.

Under the proposed system, Ms. B would only be refunded any payments made from the date in 2005 when the doctor certified her disability. The only apparent reason for denying someone like Ms. B her statutory rights is for the Department's administrative convenience. We cannot support this.

**Recommendation: Even if the Department retains the prospective evaluation period, physicians should still indicate whether the disability began prior to the date the physician signs the form and if so, a borrower that remains eligible at the end of the three year conditional period should be eligible for refund of payments made back to the date of disability.**

### **C. The Proposed Rules Weaken the Department's Incentives to Make Expedient Decisions on Discharge Applications and Further Confuse The Process**

The Department repeatedly mentions its intent to cut back on confusion in the program. However, the proposed rules inject new levels of confusion. Further, the proposed rules weaken the Department's incentives to act quickly in making disability determinations.

The proposed rules set up two evaluation periods. The first begins after the doctor completes and certifies a disability. After this time and until the Department makes a determination, the borrower cannot work and earn money or receive any new title IV loans and must return within 120 days any loan disbursements made on or after the doctor's certification date. The second period begins after the Department makes a determination. Then and only then does the three year conditional period begin.

There are a number of problems with this proposal. First, the borrower is essentially in limbo after the doctor signs the form and before the Department makes a determination. For some inexplicable reason, the borrower cannot work at all during this period as opposed to the conditional period when limited earnings are allowed. The Department attempts to address this issue by requiring the loan holder to give a borrower notice of potentially disqualifying actions, but this is not enough to protect borrowers.

Inefficiency is likely to occur as well, especially if the period between the doctor's certification and the Department's determination drags on. Unfortunately, there is no deadline for the Department to make a determination once it receives an application from a guaranty agency or from the borrower in the case of Direct Loans. Department negotiators sought to reassure borrower advocates by stating during the negotiating sessions that they anticipated that this "limbo" period would be brief. A mere statement during the negotiating sessions is far from adequate to protect borrower rights. If the Department's proposal is passed, there must be a tight time line requiring the Department to act quickly on an application.

**Recommendation: If the current proposal goes forward, it should be amended to:**  
**a. Set a time limit for the Department to make determinations after receipt of a completed application, and b. Eliminate potentially disqualifying conditions during the "limbo" period.**

### **D. The Rules Must Ensure that Collection Activity is Continuously Suspended While an Application is Pending**

An ongoing problem in the current system is that borrowers that have begun the disability discharge process and obtained doctor certification often continue to face collection efforts. In the proposed regulations, lenders are prohibited from attempting to collect after receiving the physician's certification. The Secretary is required to suspend collection after making an initial determination. The regulations, however, are unclear

about what happens after the lender submits the claim to a guaranty agency, but before the Department makes a determination. The regulations should clarify that collection should be suspended during this time as well.

#### **E. The Proposed Regulations Should Explicitly Define “New Title IV Loan” to Exclude Subsequent Disbursements**

A borrower can be disqualified during the “limbo” period described above or during the conditional discharge period if she receives a new Title IV loan. We brought up the problem during negotiating sessions that the Department has a policy of considering a subsequent disbursement of a loan as the equivalent of a new loan. This causes problems when a borrower does not take out a new loan, but gets a disbursement after the doctor has certified disability or after the Department has made a disability determination.

The Department addresses this issue only by requiring borrowers to return within 120 days of the disbursement date any title IV loans made after the doctor’s certification. However, the regulations do not make explicit that a subsequent disbursement is not a new loan. It would be illogical if a borrower returned the disbursement as required in the proposed regulations, but was still considered ineligible. However, the Department’s current policy of considering subsequent disbursements as “new loans” is illogical and unfair. There is no guarantee that the policy will end once the proposed regulations go into effect.

**Recommendation: The regulations should specify that a disbursement is not a new loan.**

#### **F. Effective Date/Trigger Events**

Should the Department move forward with these changes, the effective and trigger dates must be carefully evaluated. Borrowers who are in the process of having their discharge forms certified should not be subjected to the new restrictive timeframes. Further, those borrowers with loans in a conditional discharge period should not be penalized. These borrowers should be eligible for refunds back to the disability onset date if they obtain final discharges.

#### **II. Perkins Collection Costs §674.45: The Proposed Limits on Perkins Collection Costs are Unreasonably High.**

**Comment: We object to the proposed rules because they are unfairly punitive to borrowers. Collection fee limits in the Perkins program should be the same as in the FFEL and Direct Loan programs.**

The Department is proposing to “limit” the amount of collection costs assessed by schools against Perkins loan borrowers to 30% of the total of principal, interest and late charges for first collection efforts and 40% for second efforts. In cases of litigation, the 40% limit will be allowed plus court costs.

Currently, only “reasonable” fees are allowed, but there are no numerical limits. In contrast, fees for Perkins rehabilitations are capped at 24%.<sup>8</sup> This was the Department’s initial proposal during the negotiated rulemaking session. The allowable collection fee limit is 18.5% for FFEL and Direct rehabilitation and consolidation loans. For other collection fees in the Direct and FFEL programs, the Department has set a ceiling of 25%.

The Department claimed during the negotiated rulemaking sessions that it was motivated at least in part by reports of abusive collection fees under the current system. For example, a November 2006 *Boston Globe* article highlighted colleges in the greater Boston area that were charging collection fees in some cases up to 66% of the original debt. The majority of lawsuits filed by schools studied in the article were against students who live in lower-income or working class urban communities.<sup>9</sup>

The Department’s proposal does not adequately address the problem of abusive fees. It sets limits lower than what the worst offenders are charging, but still allows schools to charge unconscionable fees.

### **Legal Principles and Collection Fees**

It is generally assumed that the potential costs of default to the creditor are considered when pricing credit transactions. Collection fees may be charged only if those fees are explicitly provided for in the original credit contract.<sup>10</sup>

Perkins loans are not priced based on risk because they are part of a social program intended to help low-income borrowers. It is not surprising that some of the low-income borrowers receiving Perkins loans later have problems repaying.

Borrowers should be required and encouraged to meet their legal obligations. However, defaults do occur. In general, defaults arise because borrowers are in financial distress, often due to unexpected life traumas. Borrowers who drop out are also at higher risk of default. For example, in a phone survey of student loan borrowers, the Texas Guaranty Agency found that those borrowers who were in repayment were likely to have jobs related to their training both during school and afterwards, while defaulters did not.

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<sup>8</sup> 34 C.F.R. §674.39(c)(1).

<sup>9</sup> Marcella Bombardieri, “Colleges Playing Tough on Debt: Low Income Students Among the Hardest Hit”, *Boston Globe*, November 19, 2006. Available at: [http://www.boston.com/news/education/higher/articles/2006/11/19/colleges\\_playing\\_tough\\_on\\_debt/](http://www.boston.com/news/education/higher/articles/2006/11/19/colleges_playing_tough_on_debt/) (last checked August 2007).

<sup>10</sup> See generally National Consumer Law Center, *Fair Debt Collection* ch. 15 (5<sup>th</sup> ed. 2004 and Supp.).

Repayers were also more knowledgeable about their repayment options. Those who were predicted not to default but did face the highest number of combined life traumas.<sup>11</sup>

Some of these borrowers can get out of default, but only through programs that give them certain breaks, such as loan rehabilitation. The piling on of unreasonable collection fees, however, leads balances to increase so rapidly that many borrowers cannot get out of trouble.

### **The Percentage Formula is Inequitable**

The Department's proposal not only sets a high limit, but also perpetuates the inequitable system that allows schools to charge fees that are not based on actual expenses incurred against a particular borrower. This approach often leads to unfair results since the small number of defaulting consumers from whom recovery is made bears the brunt of all of a creditor's collection expenses. A number of states prohibit or limit this type of "make whole" approach for other types of consumer transactions.<sup>12</sup> For example, Iowa allows a collection agency to collect a fee from the debtor only if the fee is reasonably related to the actions taken by the collector and the collector is legally authorized to collect it.<sup>13</sup>

The two most common justifications given for the proposal during negotiations and in the *Federal Register* notice of proposed rulemaking are:

1. The need to keep the Perkins program viable; and
2. The possibility that collection agencies will not sign contracts with schools if their compensation is too low.

Both of these justifications are refuted below.

#### **A. The Department is Proposing To Balance the Perkins Fund on the Backs of Borrowers**

We agree that there are serious concerns about the viability of the Perkins loan program. However, to use this problem as a justification to gouge borrowers is unconscionable. The program will not remain alive by burying borrowers in fees. It is simply not appropriate to subsidize the Perkins program by imposing onerous fees on the borrowers who can least afford them.

The best way to assist troubled borrowers is to expand the flexible work-out, repayment, and write-off options. There will still be borrowers who cannot or do not

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<sup>11</sup> Texas Guaranty Student Loan Corporation, "Predicting Which Borrowers Are Most Likely to Default" (1998), available at: [http://www.tgslc.org/publications/reports/defaults\\_texas/ins\\_intro.cfm](http://www.tgslc.org/publications/reports/defaults_texas/ins_intro.cfm).

<sup>12</sup> These are discussed in detail in National Consumer Law Center, Fair Debt Collection §15.2.1 (5<sup>th</sup> ed. 2004 and Supp.).

<sup>13</sup> Iowa Code §537.7103(5)(c).

take advantage of these programs. Collection activity is appropriate in these cases. If the borrowers do not respond, the appropriate response is for the collector to assess whether litigation is a viable option and if so, pursue litigation or other enforcement. This includes an understanding that many borrowers do not have assets or income sufficient to warrant expensive litigation or other collection efforts.

Instead of following this model, the current system rewards prolonged collection activities that mainly serve to browbeat financially vulnerable consumers. There is no reason to reward collection agencies for racking up fees attempting to collect from borrowers who have no ability to repay. Further, there is no evidence that collection fees deter defaults.

### **B. Reduce Collector Incentives to Rack Up Fees**

The system should provide incentives for collectors to minimize their costs as much as possible. For example, collection agencies should not be trying to collect where a borrower has indicated a willingness to set up a repayment plan.

The reality is that collection agencies tend to act as aggressively as possible to pressure consumers to pay the highest amounts. They generally do not have the knowledge or incentives to help borrowers understand their flexible repayment and other rights. Private collectors have in some cases deliberately deceived consumers by misrepresenting themselves as the Department of Education. They have overcharged consumers for collection fees, used misleading tactics to track borrowers, browbeaten borrowers into unaffordable payment plans, threatened them with actions that they cannot legally take, and pressured consumers to borrow from relatives.<sup>14</sup>

An additional, serious problem is that borrowers who are aware of their rights and express those rights to collection agencies are often unable to persuade the collectors to return their files to the Department or other loan holder so that they can deal more directly with the actual holder of the loan rather than a hostile agent.

If all consumers exercised their federal fair debt rights and sent collectors a “cease communication” letter once collection efforts began, and if agencies followed the law, collection agencies would be out of business.<sup>15</sup> Instead, most consumers are not aware of their rights to force collectors to “call the question.” Collection agencies take advantage of this situation, but should not be rewarded by the government for doing so.

A number of negotiators claimed that collectors may not litigate these cases unless they receive adequate compensation. This is presumably why the Department’s proposal includes an additional amount of allowable collection fees for litigation. This is difficult to understand since the regulations at 34 C.F.R. §674.46 currently allow and will continue to allow schools and their collectors to pursue all litigation costs, including attorney’s fees. Presumably these fees may be awarded in court in addition to prior

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<sup>14</sup> See generally National Consumer Law Center, Student Loan Law ch. 4 (3d ed. 2006).

<sup>15</sup> 15 U.S.C. §1692c(c) (“cease communication” right).

collection costs. If this is not the case and the Department intends the 40% limit to apply to all costs potentially awarded during litigation, the regulations should be more explicit on this point.

A further disincentive to efficient collection agency action is the requirement in the current regulations that Perkins schools refer accounts to collection agencies if their initial efforts to collect fail.<sup>16</sup> Some negotiators at the rulemaking sessions indicated that they could collect more efficiently and cheaply in-house. We recommend that the Department revisit this policy.

Finally, there is no reason to assume that collectors would not work for lower limits. They do so in the FFEL and Direct Loan programs. Many currently accept lower fees in the Perkins program as well. Regardless, fees should not be assessed based on the amount required to keep collection agencies in business.<sup>17</sup>

It is no wonder that low-income borrowers are increasingly thinking twice about taking out loans to finance higher education. These are rational thoughts given the potential consequences. The best intentioned borrowers may run into trouble down the road. The key is to work with these borrowers rather than pile on fees that leave them no escape.

**Recommendation: Set collection fees limits for Perkins Loans at the same level as FFEL and Direct Loans.**

### III. Perkins Family Service Cancellation 34 C.F.R. §674.56

The Department's proposal seeks to clarify issues that have arisen over the years with respect to the Perkins child or family service cancellation. Among other challenges, the Second Circuit in 2005 ruled in favor of a class of borrowers who had been denied these cancellations.<sup>18</sup> This decision was based in part on the lack of clear guidelines on this issue.

During negotiated rulemaking sessions, we asked the Department to clarify one particular issue that was central to the *De La Mota* case. The Department argued in this case that attorneys working for a city social services agency were working for their client, the city agency and thus ineligible for the cancellation. The Department's interpretation was rejected by the Second Circuit.

When asked about this issue at the negotiating table, the Department's negotiators indicated that they did not intend to disqualify attorneys or others working for another

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<sup>16</sup> 34 C.F.R. §674.45(c)(1)(ii)(A).

<sup>17</sup> This argument by a collection agency was refuted in a hospital collection case. *See Bondanza v. Peninsula Hospital and Medical Center*, 23 Cal. 3d 260, 590 P. 2d 22 (Cal. 1979) (State law, according to the court, prohibited charging a fee calculated on the income that a collection agency needs or desires in order to flourish economically. Plaintiffs cannot be required to guarantee the economic well-being of the agency).

<sup>18</sup> *De La Mota v. U.S. Department of Education*, 412 F. 3d 71 (2d Cir. 2005).

client, such as a city social services agency as long as the borrowers met the other eligibility criteria. However, this clarification was not included in the preamble or regulations. We once again urge the Department to make this clarification. It was the key issue in the litigation that prompted this change, but is inexplicably not addressed or clarified in the proposed regulations.

#### **IV. Prohibited Inducements §§34 C.F.R. §682.200 and 682.401**

We generally support the Department's efforts to crack down on improper inducements. The recent scandals in the student loan industry point to the serious and widespread nature of this problem. In some cases, the proposed regulations do not go far enough, but overall we believe that they will significantly improve the situation for borrowers.

We note that improvement is likely to occur only if the regulations are aggressively enforced and if the Department moves at some point to regulate improper behavior in the private student loan market. Despite our overall support for these proposals, we note two areas of concern below.

##### **A. Enforcement**

We support the Department's efforts to improve enforcement. With respect to the Federal Trade Commission (FTC) Holder notice, the Department has improved borrower rights by extending possible borrower claims to all types of schools, not just for-profit schools. This is a significant and important change.

However, inexplicably, in two important areas the Department's proposed language at §682.209(k) does not directly mirror the FTC Holder language. These differences could seriously undermine borrower enforcement rights.

First, the proposed language at §682.209(k) applies to "any lender holding a loan." In contrast, the FTC regulation applies to "Any holder of the consumer credit contract."<sup>19</sup>

This is critical because student loans are often sold by originating lenders to entities other than lenders, including investors and others operating in the secondary market. All subsequent holders should be subject to potential claims, not just lenders.

A second inexplicable difference between the proposal and the FTC language is the provision limiting claims and defense that the borrower could assert against the school WITH RESPECT TO SUCH LOAN. In contrast, the FTC rule states "ANY HOLDER OF THIS CONSUMER CREDIT CONTRACT IS SUBJECT TO ALL CLAIMS AND DEFENSES WHICH THE DEBTOR COULD ASSERT AGAINST THE SELLER OF GOODS OR SERVICES OBTAINED PURSUANT HERETO OR WITH THE PROCEEDS HEREOF. .." The language in the proposed regulations leaves it

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<sup>19</sup> 16 C.F.R. §433.2.

unclear whether claims based on the school's misdeeds that do not relate to the loan terms or the loan origination, such as fraudulent promises regarding educational programs or job placement services, are preserved.

It is important to note that when the FTC Holder language was originally incorporated in the FFEL common promissory notes, it mirrored the FTC language in these two important ways. The original language, used for many years, stated "If this loan is made by the school, or if the proceeds of the loan are used to pay tuition and charges of a for-profit school that refers loan applicants to the lender, or that is affiliated with the lender by common control, contract or business arrangement, any holder of this Note is subject to all claims and defenses which I could assert against the school..."<sup>20</sup> Since then, the Department has changed the language in its master promissory notes.

Since this is the first time that this critical language will be codified, it is essential to get it right and to ensure that the rights that other consumers have through the FTC rules also apply to student loan borrowers. The Department should not be wedded to the language in the current master promissory note. In fact, the proposed regulations pick and choose elements of the current language. For example, the provision in the current note limiting recovery is not in the proposed regulations.

**Recommendation: The regulation should read as follows: If a borrower receives a loan from a school or a school-affiliated organization or if the lender making the loan offered or provided an improper inducement to the borrower's school or any other party in connection with the making of the loan or the proceeds of the loan are used to pay tuition and fee charges to a school that refers loan applicants to the lender or the school is affiliated with the lender by common control, contract or business arrangement, any holder of such loan is subject to all claims and defenses that the borrower could assert against the school.**

## **B. Lender Staffing Issue**

The Department has asked for comments about how to interpret the proposal allowing lenders to provide assistance to school financial aid offices on an emergency basis. The level of confusion on this issue at the negotiating table indicated that lenders and schools might try to get around this provision. At least one negotiator, for example, questioned whether a shortage of staff could be considered an emergency.

We recommend that the Department impose a blanket prohibition on lender provision of assistance to schools to fulfill financial aid duties. Many schools have already agreed to this prohibition in the College Loan Code of Conduct developed by the New York State Attorney General office.

We are sympathetic to the needs of schools during severe national emergencies. However, they should be able to find assistance from sources other than the lenders with whom they do business. Alternatively, if this complete prohibition is rejected, we

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<sup>20</sup> See U.S. Department of Education, Dear Colleague Letter from Robert W. Evans (April 16, 1993).

recommend limiting emergency situations to state or federally declared national disasters and to strictly define “short-term.”