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Defend the Department of Education's Borrower Defense Rule

Protecting Students and Taxpayers against Fraud and Abuse in Higher Education

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In November 2016, the Department of Education (Department) published rules to implement parts of the Higher Education Act (HEA) designed to protect borrowers and the federal student loan program from school fraud and abuse. The "Borrower Defense Rule" deters and protects against school fraud and closures by:

- Clarifying students' rights to raise school fraud as a defense to loan repayment, and the Department's right to recoup discharged loans from schools that perpetrated fraud;
- Restricting schools that receive federal student aid from using forced arbitration to evade accountability for and detection of fraud;
- Ensuring relief for students whose schools closed; and
- Protecting students and taxpayers by requiring the riskiest schools to warn students and to put money aside to help cover the cost if their students' loans are discharged.

The last several years have shown why this rule is needed: Schools like for-profit Corinthian Colleges have deceived students, regulators, and investors with false information about the value of their degrees, all while raking in billions in federal student aid dollars. Many schools have abruptly closed, leaving students with mounds of debt and no degree. Meanwhile, these schools have evaded accountability through forced arbitration clauses slipped into the fine print of student enrollment agreements stripping students of their rights. This issue brief explains the Borrower Defense Rule and why it is critical to protecting students and taxpayers from fraud.

Borrower Defense: A Path to Relief for Defrauded Borrowers

The Problem

- While many institutions serve students well, some have preyed on the hopes and dreams of Americans—especially those new to higher education—to better their job prospects and earnings through education. As investors in for-profit schools demanded increasing profits and companies pushed to increase enrollments and the in-flow of student loan dollars, schools engaged in fraud to convince students to enroll and take out loans (see the 2012 Senate HELP report).

- For example, the Department found that Corinthian Colleges systematically misrepresented its graduates' job placement rates to prospective students. The inflated rates promoted the school's career programs, including criminal justice, medical assisting, and business administration, as good investments. Based on this false information, hundreds of thousands of students enrolled and took out federal student loans, then found their degrees worthless. These students wasted years and took on unaffordable debt that they never would have agreed to had they known these graduate outcomes were false.

- **Americans support the borrower defense relief:** In a recent poll commissioned by New America, 78% of Americans agreed that students should have their federal student loan debt canceled if their college is found to have provided deceptive information about its programs or outcomes—this includes 87% of Democrats and 71% of Republicans.

What the Rule Does

- The new regulations create a much-needed—and long-overdue—process for defrauded borrowers to access the relief they are entitled to under the Higher Education Act.[1] The existing regulations fails to explain how borrowers can exercise this right and provides little clarity to students, schools, or the public as to how the process should operate. As a result, prior to 2015, only five borrowers out of the hundreds of thousands eligible even attempted to exercise their borrower defense rights by submitting claims for relief.

- The new rule provides a path for defrauded students and transparency about the process to all impacted parties. It does not mandate loan discharges. Instead, it lays out processes for how student loan borrowers can apply for relief, how the Department may pursue groupwide relief to provide efficient and equitable treatment for groups of borrowers who were subject to the same school misconduct, and how the Department will assess borrowers' eligibility for relief from loans and the amount of relief warranted.

- To ensure that the schools that perpetrate fraud—rather than defrauded borrowers or taxpayers—pay the cost of the fraud, the new rule, along with a procedural rule, includes processes to determine the school's obligation to pay the Department for cancelled loan amounts. By requiring schools to pay for fraud, the rule deters them from engaging in it.

Arbitration Limits: Restoring a Basic Right to Help Root out Fraud

The Problem

- As a New York Times series recently documented, forced arbitration clauses and class action bans are widely embraced by corporations as a way to insulate themselves from liability and detection of fraud and abuse. A recent analysis revealed that the majority of for-profit schools now include arbitration clauses in their student enrollment agreements, though almost no public and very few non-profit schools do.

- Forced arbitration clauses deprive students of their constitutional right to bring claims to an impartial judge or jury. Class action waivers bar students from joining together with other harmed students to challenge systemic fraud. Instead, these clauses force students to bring their claims one-by-one against the school and before a private arbitrator—often one picked and paid for by the school accused of fraud. Unlike court proceedings, arbitration is often conducted behind closed doors, preventing the public, students, and regulators from knowing about a school's illegal conduct.

- Forced arbitration silences legitimate complaints about illegal conduct, forcing claims into secretive arbitration systems or suppressing cases before they're filed. For example, for-profit school ITT aggressively used forced arbitration clauses to stop student and

[1] The HEA requires that the Department of Education specify in regulations when federal student loan borrowers may raise school misconduct as a defense against loan repayment. 20 U.S.C. § 1087e(h).

government lawsuits and public scrutiny into its conduct for years before the school abruptly closed and filed for bankruptcy in September 2016. Because forced arbitration clauses allowed ITT to insulate itself from liability and scrutiny while it was open, taxpayers and student borrowers are now paying the price of millions in federal student loans that graduates are unable to afford to pay back.

What the Rule Does

- The new regulations bar schools that want to participate in the federal student loan program from using forced arbitration clauses and class action bans to insulate themselves from liability for the same types of fraudulent conduct that could also give rise to a borrower defense to repayment.

- By bringing school fraud complaints into the open and allowing students to band together in asserting class claims, school misconduct will be made public much earlier—helping prospective students and the government to decide whether a school deserves their dollars. The rule is thus crucial to protecting both students and the integrity of the federal student loan program.

Closed Schools: Improved Relief for Students

The Problem

- Over the past few years, thousands of schools across the country have closed, even as others have opened or expanded. Schools often close abruptly—students show up for class to find a message posted on a locked door. Students are left with a broken dream. Often no reputable and reasonably accessible school is willing to accept their credits to complete their program without essentially restarting.

- Students who took out federal student loans for their education not only suffer from wasted years, but from debt incurred for a degree they could not obtain. Existing rules allow students whose school closed before they completed to apply to have their loans discharged if they do not transfer credits and complete the program elsewhere. However many students are unaware of this right and suffer with debt unnecessarily.

What the Rule Does

- The rule strengthens existing closed school discharge regulations by requiring improved, prompt communications to eligible borrowers about their rights when their school is closing—helping to ensure that more students are informed of their options and can get their loans discharged quickly.

- Even with better communication efforts, many eligible borrowers will not find out about their right to discharge. Therefore the rule also provides automatic discharges of federal student loans taken out to attend the closed school by borrowers who have not re-enrolled in another school by three years after the closure. This provides efficient and equitable relief to eligible borrowers harmed by their school’s closure.

Financial Responsibility: Requiring Risky Schools to Put Money Aside for Potential Discharges and Warn Students

The Problem

- School fraud and abrupt closures pose threats to both students and taxpayers. Students should not be the last to know when their school is in trouble. And schools should be required to bear the cost when they defraud student loan borrowers or close before students can complete their program.

What the Rule Does

- The rule protects taxpayers by amending the financial responsibility standards to include actions and events that would trigger a school to provide financial protection to insure against future borrower defense claims, closed school discharges, or other liabilities to the Department. Triggers include a court judgment or status reflecting that a school program could become ineligible for federal aid the next award year. The Department is authorized to recoup the costs of these discharges from the schools that caused the harm, and this provision better ensures that schools are able to pay such costs.

- The rule helps prospective and current students better understand the risk of a school by requiring schools to disclose on their websites and to prospective students if they are required to provide such financial protection. The rule also better informs prospective students about a program's value. It requires for-profit schools with poor loan repayment outcomes—where the average borrower has not made a dent in their loan balance—to include a plain-language warning in their advertising and promotional materials.

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