

Designing Regulations to Protect Federal Student Loan Borrowers: Closed School Discharge

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Executive Summary

In April, 2015 the National Association of Student Financial Aid Administrators (NASFAA) joined a collaboration to assist students whose college or career school closed while they were attending or shortly after they withdrew. This collaboration, a response to the closure of Corinthian College, received hundreds of student inquiries in the first 24-hours. In the more than two years since NASFAA has continued this work, thanks to funding from Lumina Foundation, and assisted more than 6,000 students from the over 25 institutions that have closed (some of which had multiple campuses). Our participation in this work is made possible by NASFAA's members, seasoned financial aid administrators from across the country, who have volunteered to answer student questions and provide guidance.

While the Department of Education (ED) has provided some guidance for displaced students, many of whom may qualify for federal loan discharge, a large gap in financial aid knowledge remains for this population. As a mission-driven organization, NASFAA welcomed the opportunity to participate in helping these students understand their financial aid options. NASFAA members—financial aid administrators—are glad to provide knowledge and service to the students who were impacted by these school closures, with the hope that given the right guidance, they will continue their educational careers.

To address the issues outlined above, NASFAA commissioned a paper examining current federal student loan provisions for students whose college or career schools closed while they were attending or shortly after they withdrew. Based on this research we present seven recommendations, which are outlined in more detail throughout this report:

- ❖ **Recommendation #1:** Eligibility for discharge should depend on the number of credits earned at the closed institution and not successfully transferred and students should only be responsible for repaying the share of their debt that could lead to a credential.
- ❖ **Recommendation #2:** Borrowers whose schools close should immediately be informed that they may be eligible for loan discharge and the processing should be as quick as possible.
- ❖ **Recommendation #3:** Borrowers who did not receive credentials before their schools closed should be eligible for at least partial discharge.
- ❖ **Recommendation #4:** There should be a limit on the interest that can accrue on loans that are in forbearance while applications for discharge are in process.
- ❖ **Recommendation #5:** Students enrolled at schools that close should immediately be automatically informed that if they are not in a teach-out program, they are eligible for discharge of loans for any credits that have not been transferred to another institution.
- ❖ **Recommendation #6:** The opportunity for group discharges when appropriate should be cautiously expanded.
- ❖ **Recommendation #7:** The discharge application process should migrate to a completely online format, reducing the time and expense involved in processing applications.

These recommendations underscore the importance of policies that balance the interests of students, institutions, and taxpayers in the event of school closings. Loan discharge provisions must preserve the goal of educational opportunity that is fundamental to the loan program, while at the same time enforcing borrower responsibility and avoiding excessive costs to taxpayers.

Background

The federal student loan program increases access to postsecondary education by allowing students to borrow on reasonable terms, with the expectation that they will be able to repay their debts out of the earnings premium college generates. But not all borrowers experience this financial benefit, and it is imperative that the program include protections for students whose outcomes make repaying their debts unmanageable. This paper focuses on the specific provisions designed to protect students when their schools close before they complete their degrees.

Federal income-driven repayment (IDR) programs provide insurance that protects borrowers whose education does not pay off as quickly or as well as they might have anticipated.¹ While many borrowers can reasonably repay their debts over the long run, they may have periods of low earnings when being able to reduce or postpone payments can alleviate the hardship. For those whose earnings never support their debt, these programs forgive remaining balances after some number of years.

Repayment insurance programs like the IDR plans are important and necessary, but do not provide adequate protection for students facing the unusual situation of attending institutions that close before they complete their programs. These students may be unable to transfer their credits to other institutions and may be left with nothing to show for the time and money they have invested.

School closings harm both students who pay out of pocket and those who borrow to finance their education. Institutions might be held responsible for refunding tuition payments in some cases. However, when the federal government makes loans to students who enroll in approved institutions that end up closing before they complete their credentials, it shares some of the responsibility for compensating borrowers for their losses and in many cases, it is unreasonable to expect full repayment of loans.²

The design of loan discharge policies should balance the interests of students, institutions, and taxpayers. Student loan provisions should preserve the goal of educational opportunity that is fundamental to the loan program, while at the same time enforcing borrower responsibility and avoiding excessive costs to taxpayers. Below, we examine existing and proposed provisions for closed school discharge from the perspectives of equity and efficiency and propose reforms that would strengthen these policies.

¹ See an overview of programs at Federal Student Aid, <https://studentaid.ed.gov/sa/repay-loans/understand/plans/income-driven>.

² This paper does not address Borrower Defense to Repayment provisions for victims of institutional misrepresentation or fraud, another circumstance requiring special protections.

Recommendations

We make the following recommendations based on our evaluation of the equity and efficiency of specific provisions for eligibility for closed school discharge and of the processes for application for and granting of relief.

Recommendation #1

Eligibility for discharge should depend on the number of credits earned at the closed institution and not successfully transferred, rather than on a judgment about whether or not a student's former and new programs are comparable. Students should be responsible for repaying only the share of their debt that financed the education that could lead to a credential even after the school closure.

Recommendation #2

Borrowers whose schools close should immediately be informed that they may be eligible for loan discharge and the process should be as quick as possible so students are encouraged to continue their education in a timely manner.

Recommendation #3

Borrowers who did not receive credentials before their schools closed should be eligible for at least partial discharge, whether or not they completed their coursework before the closure.

Recommendation #4

There should be a limit on the interest that can accrue on loans that are in forbearance while applications for discharge are in process.

Recommendation #5

Students enrolled at schools that close should immediately be automatically informed that if they are not in a teach-out program, they are eligible for discharge of loans for any credits that have not been transferred to another institution.

Recommendation #6

The opportunity for group discharges when appropriate should be cautiously expanded.

Recommendation #7

The discharge application process should migrate to a completely online format and use modern verification technologies to authenticate users' identities, reducing the time and expense involved in processing applications.

Eligibility for Closed School Loan Discharge

Under the Higher Education Act, students may be eligible for a 100 percent discharge of their federal student loans if their school closes while they are enrolled, preventing them from completing their programs.³ Students who withdrew from the school no more than 120 days before it closed may also be eligible for loan discharge. Borrowers may be eligible to have outstanding balances, including accrued interest and charges, forgiven and to have payments already made refunded.

In this paper, we address the following components of the determination of eligibility for closed school federal loan discharge that could reasonably be modified through the regulatory process:

Component #1: Students who are able to complete their programs through a teach-out agreement or who enroll in a similar program, transferring any of their credits, are not eligible for a loan discharge.⁴

The logic behind distinguishing between students who enroll in similar programs at other institutions and those who do not is to compensate only students harmed by the interruption in their studies. However, the current distinction may lead to undesirable changes in students' choices. Because students who successfully transfer credits to completely different programs at other schools are eligible for discharge, but those who transfer credits to "comparable" programs are not, there is an incentive for students to switch their academic paths. Even if they were satisfied with and successful in their original course of study, they may be financially better off—at least in the short run—if they make a different choice.

This provision draws a hard distinction between programs that are comparable and those that are not. It may be clear that a student who was studying to be a medical technician at a school that closed and then enrolled in a business management program is not in a comparable program. However, there are many more shifts in academic programs that are less clear, such as a move from an associate degree program in medical technology to a certificate program in the same field, or a move from a nursing assistant program to a home health aide program.

In addition to the inefficiency of encouraging changes in career paths, the current distinction between students who enroll in similar programs at other institutions and those who do not, raises equity concerns. For example, students whose educational trajectories are similarly affected by school closings, in the sense that they lost equal amounts of credit, are sometimes treated differently. Some groups of students may be able to navigate their enrollment options simply due to their geography, access to more social networks, and other resources to increase their chances of loan discharge, while others may not.

In order to move away from these arbitrary distinctions that have the potential to generate significant unintended inefficiencies, the question should be whether or not a student's credits transfer. Under existing provisions, students can have all their loans discharged even if they were able to transfer credits to a new, different type of program. However, they are disqualified if even one of their credits transferred to a comparable program, so they may be required to repay loans for many credits that did not transfer. These students have lost at least part of their investments and should be eligible for discharge.⁵

³ See HEA §437(c)(1); HEA §455(a)(1); and HEA §464(g).

⁴ See 34 C.F.R. §§674.33(g)(4); 682.402(d); and 685.214(c).

⁵ Transferring credit can be exceedingly complex and costly for some students. It often means paying a fee and submitting one or more applications, agreeing to enroll, obtaining official transcripts from a closed institution, and then going through a degree audit process with a new institution but without access to faculty at the former institution who can provide syllabi or other course information. This process takes time and resources and students may need access to transition counseling as part of the closing process to help them deal with school/program choice, financial aid, and credit audits.

A more equitable provision would allow complete discharge for students if they are not in a teach-out program and none of their credits have transferred and partial discharge, pro-rated according to the share of credits that have transferred to any other program.

Component #2: Students who completed their coursework before the school closed are not eligible for a closed school loan discharge, even if they have not received a degree or certificate.⁶

Completed credits are not of much use if they do not lead to a credential. Private foundations and other organizations are making considerable effort to seek out adults who have completed the requirements for degrees but have not received them. Their goal is to help these individuals obtain their credentials so they can benefit from the labor market return. It is not constructive for the closed school discharge policy to create more individuals in this category.

This rule arbitrarily distinguishes between students who have completed all their degree requirements but have not received a degree, and those who have not yet met all of the requirements. If students have no way to get the degree for which they have completed the requirements, they will be left without a credential, despite their investments.

Component #3: Borrowers must continue making payment on their loans while their discharge applications are under review unless they enter forbearance. Interest accrues during forbearance, even on Subsidized Stafford Loans.⁷

Forbearance appropriately suspends required payments for borrowers who have applied for discharge and are awaiting resolution of their claims. However, interest will accrue and the amount they owe will increase. Since there is no limit on the amount of time it might take for a discharge application to be approved or rejected, this process could have serious implications for those whose loans do not end up being discharged.

The timing of the discharge process is not within the borrower's control, raising questions about the equity of encouraging a process that increases the amount they owe by an unpredictable amount. The best solution is to impose a strict limit on how long the Department can take to resolve the claims. However, it may also be appropriate to limit the interest that can accrue during this period. For example, interest could accrue for three months, but beyond that, the amount owed would be frozen until the discharge application is settled. Allowing interest to accrue for a period of time would discourage frivolous claims, but limit the harm to borrowers whose claims do not meet all of the requirements for discharge.

⁶ See <https://studentaid.ed.gov/sa/repay-loans/forgiveness-cancellation/closed-school>.

⁷ See <https://studentaid.ed.gov/sa/repay-loans/forgiveness-cancellation#payments-during-review> and also [§682.402 \(d\)\(6\)\(i\)\(I\)](#).

Loan Discharge Filing Processes

Students whose schools close may not be aware that they might be eligible to have their loans discharged. Even if they are aware of the possibility, filing requirements that are difficult to understand and complicated processes can be a disincentive to applying for relief. If the government is serious about fairly compensating people who have been wronged, filing processes should be as simple as possible, while still gleaning the information necessary to reliably determine eligibility for loan discharge.

The regulations developed by the Obama administration's rulemaking process would have addressed several issues in the loan discharge process if they had been implemented as scheduled in July 2017, but they are indefinitely on hold and will be re-negotiated.

We address the following issues related to the process of applying for loan discharge:

***Issue #1: Borrowers seeking to discharge student loans after their schools close must fill out applications and wait.**⁸ The Department of Education made an exception for some former students from the American Career Institute, discharging their loans en masse.⁹*

According to the Federal Student Aid website, borrowers whose schools have closed should contact their lenders/servicers and submit applications. At the point of application, loans can qualify for forbearance for up to 12 months. (Interest continues to accrue whether the loan is subsidized or unsubsidized.)

The rules and regulations scheduled to go into effect on July 1, 2017, would have brought significant efficiencies into the process by simplifying some types of loan discharges, in particular by expanding the circumstances under which automatic loan discharge would be granted for certain groups and at the discretion of the Secretary. It would be most efficient if a provision were adopted that would allow loan discharge in the absence of an application for groups of eligible borrowers, preferably as soon as a school closes.

There is a tension between discharging loans as quickly as possible to remove the burden from students and imposing a waiting period to give students time to re-enroll and transfer their credits. No matter how long the waiting period is, there may be borrowers who go back to school at a later date and benefit from some of the credits they earned earlier. But since students may hesitate to take out new loans to go back to school as long as their old loans are hanging over them, loans should be discharged as quickly as is feasible after a school closure, taking as much advantage as possible of automatic and group discharge.

It would be most equitable to automatically consider all students who were enrolled at a closed school for loan discharge at the same time, rather than discharging the loans of those who apply early regardless of their future plans, but disqualifying those who wait and have then gone back to school.

Regulations developed by the Obama administration but not implemented would have allowed for automatic discharge of loans for borrowers who were enrolled in schools that closed and who did not re-enroll and successfully transfer credits within three years. Automatic discharge for students who do not apply on their own is important, but immediate discharge might encourage more students to go back to school and more quickly become skilled members of the workforce, in addition to eliminating inequities based on the timing of applications for discharge.

⁸ See <https://ifap.ed.gov/dpccletters/attachments/GEN1418AttachLoanDischargeAppSchoolClosure.pdf>.

⁹ See <https://www.nasfaa.org/news-item/10947/ED-Announces-Automatic-Loan-Discharge-For-American-Career-Institute-Borrowers>.

Issue #2: There is no clear standard for predicting which students might be granted group discharge without individual applications.¹⁰ In fact, without the full acceptance of the provisions that emerged in the 2016 rulemaking process, it is unclear whether specialized group processing will continue.

The ultimate aim of new rules and regulations should be to reduce the need for case-by-case review of applications. In the case of school closure, all borrowers would be eligible for consideration for discharge.

Group discharges should be used cautiously to avoid undue costs to taxpayers. However, the costs of processing individual applications and generating long wait times are also high.

Issue #3: The application process for loan discharge is confusing and antiquated and includes ambiguous definitions.

Applying for a closed school loan discharge requires responding to 22 mostly yes-or-no questions using a fillable PDF document that can be electronically completed, then printed out, signed, and submitted via mail. While confusing questions remain—most notably the unresolved question of what a “comparable” program of study means—this simplification of a potentially complex process is commendable. The process would be further improved if it could be carried out completely online, removing the need for printing, mailing, and processing time.

The rules as written appropriately allow for the suspension of collection activity until the claim is settled. However, methods of claim review should allow for more timely processing and, as recommended above, the accrual of interest during the processing period should be limited.

In the context of student filing processes, the most obvious way to save money is to reduce the amount of staff time needed to process applications. This could entail reducing the overall number of students required to file an application (i.e., by broadening the scope of who is automatically eligible for discharge). It could also entail simplifying the application itself, in much the same way that advocates support reducing the number of required questions on the FAFSA.

The critical question here is: What is the minimum amount of information necessary to credibly determine whether the claim meets the requirements for discharge? This could be facilitated by automating some aspects of the application process. ED should not require borrowers to answer questions such as enrollment status to which the answers are available in Department records. Migrating these processes to an online format and using modern verification technologies to authenticate users’ identities would reduce the time and expense of the mailing, receiving, opening, sorting, filing, and reviewing, of notarized, paper-based documents.

¹⁰ See <https://ifap.ed.gov/dpccletters/attachments/GEN1418AttachLoanDischargeAppSchoolClosure.pdf>.

Summary

An overarching goal of the programs for loan discharge should be to diminish the barriers and increase the incentives for borrowers to complete credentials of value. Any rules or processes that cause students to delay their return to school or to radically change their courses of study are counter to this goal.

The students most likely to be victims of school closures are those who already face considerable barriers to postsecondary success. Barriers to success are particularly large for those who live in “education deserts” without brick-and-mortar institutions, in areas with low connectivity to the internet, or whose work takes them overseas. Any new policies, or modifications to existing policies, should make every effort to support persistence in educational programs.

The central tension in designing appropriate loan discharge policies is to balance the responsibilities the government has to individual student borrowers with those it has for taxpayers as a whole. The goal should not be to make the regulations as generous as possible, always giving students the benefit of the doubt and minimizing the barriers to loan discharge. It should be to relieve debt students have incurred for education that has not paid off because of institutional inadequacies that interfere with borrowers’ ability to achieve their educational goals, earning postsecondary credentials of value.

Ultimately, the federal government will best serve both students and taxpayers if it is more careful in setting limits on the institutions eligible for Title IV aid. Reducing the number of students who borrow to attend institutions that are at high risk of closure is a much more sensible policy than devoting substantial resources to discharging debt. Discharging debt comes at a high cost to taxpayers and cannot fully compensate students for the time and resources they have devoted to their work at these institutions.

The federal government should reduce the extent to which the specific provisions for closed school discharge alter the behavior of students and or institutions in unintended ways, discouraging students from completing the credentials that will be most valuable to them. The regulations should treat borrowers equitably, not making arbitrary distinctions among borrowers in similar circumstances. Students should not have to repay debts incurred to fund enrollment leading to credits that did not lead to credentials because their schools closed.

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