

**Issue Papers 1-3**  
**Session 2: February 17-19, 2016**

**Issue 1:** Whether to establish a new standard for the purpose of determining whether a borrower can establish a defense to repayment on a loan based on an act or omission of a school.

**Statutory cite:** §455(h) of the Higher Education Act of 1965, as amended

**Regulatory cite:** 34 CFR 668.71, 685.206(c), 682.209(g), 685.205, 685.222

**Issue 2:** Time period for availability of Borrower Defense to Repayment claims

**Statutory cites:** §455(h) of the Higher Education Act of 1965, as amended, 20 U.S.C. 1087e(h)

**Regulatory cites:** 34 CFR 685.206(c), 685.222

**Issue 3:** Developing a regulatory framework for the process of submitting, reviewing, and determining the veracity of Borrower Defense to Repayment (DTR) claims.

**Statutory cite:** §455(h) of the Higher Education Act of 1965, as amended

**Regulatory cite:** 34 CFR 685.206(c), 685.222

**Summary of changes:**

Creates a new regulatory section that establishes for borrower defense to repayment a Federal standard, limitations period, and processes for borrower-initiated claims, claims initiated by the Secretary, investigation and response for institutions, and final determinations.

**Changes:** See attached regulatory text. Generally, modified text is shown in redline. However, §685.222 is an entirely new section of the regulations and is not depicted in redline.

**§668.71 Scope and special definitions.**

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(c) The following definitions apply to this subpart:

*Misrepresentation:* Any false, erroneous, or misleading statement that an eligible institution, one of its representatives, or any ineligible institution, organization, or person with whom the eligible institution has an agreement to provide educational programs, or to provide marketing, advertising, recruiting, or admissions services, makes directly or indirectly to a student, a prospective student, a member of the public, an accrediting agency, a State agency, or the Secretary. A misleading statement includes any statement that has the likelihood or tendency to deceive. A statement is any communication made in writing, visually, orally, or through other means. Misrepresentation includes any statement that omits facts in such a way as to make the statement false, erroneous, or misleading.

Misrepresentation also includes the dissemination of a student endorsement or testimonial that a student gives either under duress or because the institution required the student to make such an endorsement or testimonial to participate in a program.

*Prospective student:* Any individual who has contacted an eligible institution for the purpose of requesting information about enrolling at the institution or who has been contacted directly by the institution or indirectly through advertising about enrolling at the institution.

*Substantial misrepresentation:* Any misrepresentation to a person on which that person could reasonably be expected to rely, or has reasonably relied, to that person's detriment.

#### **§685.206 Borrower responsibilities and defenses.**

(a) The borrower must give the school the following information as part of the origination process for a Direct Subsidized, Direct Unsubsidized, or Direct PLUS Loan:

(1) A statement, as described in 34 CFR part 668, that the loan will be used for the cost of the student's attendance.

(2) Information demonstrating that the borrower is eligible for the loan.

(3) Information concerning the outstanding FFEL Program and Direct Loan Program loans of the borrower and, for a parent borrower, of the student, including any Federal Consolidation Loan or Direct Consolidation Loan.

(4) A statement authorizing the school to release to the Secretary information relevant to the student's eligibility to borrow or to have a parent borrow on the student's behalf (e.g., the student's enrollment status, financial assistance, and employment records).

(b)(1) The borrower must promptly notify the Secretary of any change of name, address, student status to less than half-time, employer, or employer's address; and

(2) The borrower must promptly notify the school of any change in address during enrollment.

(c) Borrower defenses. (1) For loans first disbursed prior to July 1, 2017, the borrower may assert as a defense to repayment, any act or omission of the school attended by the student that relates to the making of the loan or the provision of educational services that would give rise to a cause of action against the school under applicable State law.

(2) (i) To assert a defense to repayment of a Direct Loan, the borrower must follow the procedures in §685.222.

(ii)(A) For a defaulted Direct Loan, if the borrower asserts both a defense to repayment under this section and any other objection to an action of the Secretary with regard to that defaulted Direct Loan, the Secretary notifies the borrower of the order in which the Secretary considers the defense to repayment and any other objections. Except as provided in the notification, the Secretary considers the defense to repayment through the completion of the procedures in §685.222 first and then, as needed, any other objections under the procedures applicable to the particular action.

(B) The Secretary defers any action to report a debt as in default, and defers or suspends any action to collect in accordance with §685.222(e)(3)(i).

(3) If the borrower's defense to repayment is successful, the Secretary notifies the borrower that the borrower is relieved of the obligation to repay all or part of the loan and associated costs and fees that the borrower would otherwise be obligated to pay. The Secretary affords the borrower such further relief as the Secretary determines is appropriate under the circumstances. Further relief may include, but is not limited to, the following:

- (i) Reimbursing the borrower for amounts paid toward the loan voluntarily or through enforced collection.
- (ii) Determining that the borrower is not in default on the loan and is eligible to receive assistance under title IV of the Act.
- (iii) Updating reports to consumer reporting agencies to which the Secretary previously made adverse credit reports with regard to the borrower's Direct Loan.

(4) The Secretary may initiate an appropriate proceeding to require the school whose act or omission resulted in the borrower's successful defense to repayment of a Direct Loan to pay to the Secretary the amount of the loan to which the defense applies in accordance with §685.222(l).

**§685.222 Borrower defense to repayment.**

(a) General. (1) For loans first disbursed prior to July 1, 2017, the Secretary discharges the borrower's obligation to repay a Direct Loan in accordance with the provisions of §685.206(c).

(2) For loans first disbursed on or after July 1, 2017, the Secretary discharges the borrower's obligation to repay a Direct Loan in accordance with the provisions of this section if there is sufficient evidence demonstrating that the borrower has a defense to repayment that relates to the making of the loan or the provision of educational services and meets the requirements under paragraphs (b), (c), or (d) of this section.

(3) A violation by the school of an eligibility or compliance requirement in the Higher Education Act or its implementing regulations is not a basis for a borrower defense to repayment claim unless the violation would otherwise constitute a basis for a borrower defense to repayment claim under this section.

(4) For the purposes of this section, "borrower" means--

(A) The borrower; and

(B) In the case of a Direct PLUS Loan, the student and any endorsers.

(b) Judgment against the school. The borrower has a defense to repayment under this section if the borrower, whether as an individual or as a member of a class, has obtained, or a governmental agency has obtained for the borrower's benefit, a favorable judgment in a court of competent jurisdiction against the school. A borrower may assert a defense to repayment under this paragraph (b) at any time.

(c) Breach of contract by the school. The borrower has a defense to repayment under this section if the school the borrower received a Direct Loan to attend failed to perform its obligations under the terms of a contract with the student. A borrower may assert a defense to repayment under this paragraph (c) not later than two years after the breach by the school of its contract with the student.

(d) Substantial misrepresentation by the school. The borrower has a defense to repayment under this section if the school or any of its representatives, or any institution, organization, or person with whom the school has an agreement to provide educational programs, or to provide marketing, advertising, recruiting, or admissions services, made a substantial misrepresentation in accordance with 34 CFR part 668, subpart F, that the borrower relied on when the borrower decided to attend, or to continue attending, the school. A borrower may assert a defense to repayment under this paragraph (d) within two years after the borrower discovers, or reasonably could have discovered, the facts constituting the substantial misrepresentation.

- (e) Discharge application. (1) To obtain a discharge of a loan under this section, a borrower must--
- (i) Submit a discharge application to the Secretary, on a form approved by the Secretary--
    - (A) Certifying that the borrower received the proceeds of a loan, in whole or in part, to attend a school;
    - (B) Providing material that supports the borrower's defense to repayment; and
    - (C) Indicating whether the borrower has made a claim with respect to the school's actions with any third party, such as the holder of a performance bond or a tuition recovery program, and, if so, the amount of any payment received by the borrower or credited to the borrower's loan obligation; and
  - (ii) Provide any other information or supporting documentation requested by the Secretary.
- (2) The application for discharge may be filed or pursued as applicable by an individual borrower, a representative on the behalf of a group of borrowers with common facts and claims, or the Secretary on behalf of a group of borrowers identified by the Secretary, under procedures to be determined by the Secretary.
- (3) Upon receipt of a borrower's discharge application, the Secretary—
- (i) Unless the borrower is in default on the loan for which a defense to repayment has been asserted, grants forbearance and—
    - (A) Notifies the borrower of the option to decline the forbearance and to continue making payments on the loan; and
    - (B) Provides the borrower with information about the availability of the income-contingent repayment plans under §685.209 and the income-based repayment plan under §685.221.
  - (ii) If the borrower is in default on the loan for which a defense to repayment has been asserted—
    - (A) Suspends collection activity on the loan until the Secretary issues a decision on the borrower's claim;
    - (B) Notifies the borrower of the suspension of collection activity and explains that collection activity will resume if the Secretary determines that the borrower does not qualify for discharge; and

(C) Notifies the borrower of the option to continue making payments under a rehabilitation agreement or other repayment agreement on the defaulted loan.

(f) Process for review of a discharge application. (1) Initial review. Upon receipt of a borrower's discharge application, the Secretary reviews the application; may seek and consider any additional information relating to the application; and provides the borrower any official records pertinent to resolution of the claim that the borrower reasonably requests. A borrower's claim for defense to repayment is then resolved in accordance with the following procedures.

(2) Discharge applications with respect to loans made to attend a closed school. For a discharge application made with respect to a Direct Loan to attend a school that has closed and has provided no financial protection currently available to the Secretary from which to recover any losses from a loan discharged under this section, or from which the Secretary cannot otherwise recover such losses--

(i) If, after the Secretary's initial review, the Secretary approves the borrower's defense to repayment claim, the Secretary notifies the borrower in writing of that decision and the relief provided on the basis of that claim as determined under paragraph (g) of this section; or

(ii) If, after the Secretary's initial review, the Secretary denies the borrower's defense to repayment claim, the Secretary notifies the borrower in writing of that decision and notes the portion of the loan that is due and payable to the Secretary, and informs the borrower that the loan will return to its status prior to the borrower's discharge application.

(3) Discharge applications with respect to loans made to attend an open school. For a discharge application made with respect to a Direct Loan to attend an open school or a school that is not otherwise covered by paragraph (f)(2) of this section, the borrower's claim for defense to repayment is resolved in accordance with the procedures in this paragraph (f)(3).

(i) The claim will be resolved through a fact-finding process established by the Secretary in which both the school and the borrower will be given the opportunity to participate. A hearing official will decide the claim and issue a written decision on the claim.

(ii) At the Secretary's discretion and with the borrower's consent, the Secretary may designate a department official to present the borrower's claim in the process described in paragraph (f)(3)(i) of this section.

(iii) At the Secretary's discretion and with the borrowers' consent, the Secretary may consolidate borrowers' claims involving common questions of law or fact for the purposes of the process established under paragraph (f)(3)(i) of this section.

(iv) If a borrower's defense to repayment is approved under the procedures in paragraph (f)(3) of this section, the Secretary notifies the borrower in writing of that decision and the relief provided on the basis of that claim as determined under paragraph (g) of this section.

(v) If a borrower's defense to repayment is not approved under the procedures in paragraph (f)(3) of this section, the Secretary notifies the borrower in writing of that decision and notes the portion of the loan that is due and payable to the Secretary, and that the loan will return to its status prior to the borrower's discharge application.

(g) Relief pursuant to discharge. If the borrower's defense to repayment claim is approved under the procedures in paragraph (f) of this section—

(1) The Secretary or the hearing official, as applicable, determines the borrower's injury arising out of the facts underlying the borrower's defense to repayment. The borrower's injury may be calculated based on one or more of the methods described in Appendix [A] to this section.

(2) The Secretary discharges the borrower's obligation to repay all or part of the loan and associated costs and fees that the borrower would otherwise be obligated to pay. In determining the amount of

the discharge, the Secretary or the hearing official, as applicable, considers the borrower's injury as determined under paragraph (g)(1) of this section.

(3) The Secretary or the hearing official, as applicable, affords the borrower such further relief as the Secretary or the hearing official determines is appropriate under the circumstances. Such further relief includes, but is not limited to, one or more of the following:

(i) Reimbursing the borrower for amounts paid toward the loan voluntarily or through enforced collection.

(ii) Determining that the borrower is not in default on the loan and is eligible to receive assistance under title IV of the Act.

(iii) Updating reports to consumer reporting agencies to which the Secretary previously made adverse credit reports with regard to the borrower's Direct Loan.

(4) The total amount of the relief granted with respect to the defense to repayment cannot exceed the amount of the loan and any associated costs and fees and will be reduced by the amount of any refund, reimbursement, indemnification, restitution, compensatory damages, settlement, debt forgiveness, discharge, cancellation, compromise, or any other benefit received by, or on behalf of, the borrower that was related to the borrower's defense to repayment claim.

(5) The decision of the Secretary or the hearing official, as applicable, is final as to the merits of the claim and any relief that may be warranted on the claim.

(h) Cooperation by the borrower. To obtain a discharge under this section, a borrower must cooperate with the Secretary in any proceeding under paragraph (f) of this section. The Secretary may revoke any discharge granted to a borrower who fails to satisfy his or her obligations under this paragraph (h).

(i) Transfer to the Secretary of the borrower's right of recovery against third parties. (1) Upon any discharge under this section, the borrower is deemed to have assigned to, and relinquished in favor of, the Secretary any right to a loan refund (up to the amount discharged) that the borrower may have by

contract or applicable law with respect to the loan or the contract for educational services for which the loan was received, against the school, its principals, its affiliates, and their successors, its sureties, and any private fund, including the portion of a public fund that represents funds received from a private party.

(2) The provisions of this paragraph (i) apply notwithstanding any provision of State law that would otherwise restrict transfer of those rights by the borrower, limit or prevent a transferee from exercising those rights, or establish procedures or a scheme of distribution that would prejudice the Secretary's ability to recover on those rights.

(3) Nothing in this paragraph (i) limits or forecloses the borrower's right to pursue legal and equitable relief against a party described in this paragraph (i) for recovery of any portion of a claim exceeding that assigned to the Secretary or any other claims arising from matters unrelated to the claim on which the loan is discharged.

(j) Discharge procedures initiated by the Secretary. The Secretary may, after determining that there may be a basis for a defense to repayment under any of paragraphs (b), (c), or (d) of this section, identify and contact any other Direct Loan borrower who may have a claim for a loan discharge on the same basis.

(k) Recovery by the Secretary. The Secretary collects from the school the amount of relief resulting from a successful defense to repayment claim.

#### **§ 685.308 Remedial actions.**

(a) The Secretary requires the school to pay the Secretary the amount of losses the Secretary incurs on loans that the Secretary determines to be unenforceable because of an act or omission of the school or dischargeable under §685.214, §685.215(a)(1)(i), (ii), or (iii), or §685.216 or that were disbursed

(i) to an individual, because of an act or omission of the school, in amounts that the individual was not eligible to receive or

(ii) because of the school's violation of a Federal statute or regulation.

(b) In requiring a school to repay funds to the Secretary for losses identified in an audit or program review, the Secretary follows the procedures described in 34 CFR part 668, subpart H. For other losses, the Secretary follows the procedures applicable to the determination of those losses.

(c) The Secretary may impose a fine or take an emergency action against a school or limit, suspend, or terminate a school's participation in the Direct Loan Program in accordance with 34 CFR part 668, subpart G.

## **Appendix A**

The Secretary or the hearing official, as appropriate, may consider a number of factors in light of each borrower's unique circumstances in determining the amount of a borrower's injury where complete relief is not warranted, including but not limited to:

(A) The difference in tuition between the program attended by the student and the average tuition for a comparable pool of programs, as determined by the Secretary;

(B) The difference between the amount of financial charges the student could have reasonably believed the school was charging, and the actual amount of financial charges made by the school;

(C) The difference between the student's earnings (i) one year after leaving the program or school, and (ii) the average salary publicized by the school as being earned by its graduates in the previous year or, if such data is not available, the expected salary for the program's designated occupation(s) or field, as determined by the U.S. Bureau of Labor Statistics, using the lowest decile of earnings for that occupation as reported in the U.S. Bureau of Labor Statistics;

(D) The total amount of the student's economic loss, less the value of the benefit, if any, of the education obtained by the student. Economic loss, for the purposes of this section, may be no greater than the cost of attendance. Economic loss also includes the amount the institution collected and failed to pay to third parties on behalf of the student for license fees or any other purpose. Economic loss does not include transportation, application fees, or non-pecuniary damages such as inconvenience, aggravation, emotional distress, or punitive damages. The value of the benefit of the education, for the purposes of this section, may include transferable credits obtained by the student; and for gainful employment programs, qualifying placement in an occupation within the Standard Occupational Classification (SOC) code for which the training was provided, provided the student's earnings meet the

expected salary for the program's designated occupation(s) or field, as determined in accordance with paragraph (c)(2)(C); and

(E) Such other factors as determined by the Secretary.