THE SECRETARY OF EDUCATION
WASHINGTON, DC 20202

February 27, 2013

Honorable Tom Harkin
United States Senate
Washington, DC 20510

Dear Mr. Chairman:

Thank you for your letter of December 12, 2012, commending the Administration's efforts to strengthen and protect the integrity of the Federal student aid programs. I appreciate your recognition of the Department's significant work in this area. We are committed to using available resources to ensure that institutions are providing high-quality education that prepares students to enter the workforce. An identical response is being sent to the other signers of your letter.

Your letter expressed concern about the actions you believe some for-profit institutions are taking to evade the consequences of the institution's cohort default rate as provided in the Higher Education Act (HEA). One of the actions you cited was institutions encouraging or harassing borrowers to delay payments on their loans for the cohort period through the use of deferment or forbearance to artificially reduce the institution's cohort default rate (CDR), leaving former students with significantly increased interest over the life of the loan. The second action you cited was some institutions attempting to consolidate their Office of Postsecondary Education Identification (OPE-ID) numbers to avoid CDR sanctions and 90/10 revenue violations that could lead to an institution's loss of federal student financial aid eligibility. You asked the Department to investigate these tactics in order to protect students and taxpayers. You also asked us to examine how we might better define and detect CDR manipulation, and to provide clear guidance on appropriate default aversion or management policies.

An institution's cohort default rate, as defined in section 435(m) of the HEA, measures the percentage of an institution's current and former students who enter repayment in a given Federal fiscal year on Federal Stafford Loans, Federal Direct Subsidized and Unsubsidized Loans, or on the portion of a Federal or Direct Consolidation Loan that repaid such loans, that were received for attendance at the institution and who default on those loans by the end of the second fiscal year following the year in which the borrower entered repayment. Borrowers who are granted a non-payment forbearance or who qualify for a deferment, or who request an income-driven repayment plan (i.e., the Income-Based Repayment (IBR) Plan, the Pay As You Earn Repayment Plan, and the Income-Contingent Repayment (ICR) Plan), and have a scheduled payment of $0, are unlikely to default during the cohort period and will not be included in the numerator of the institution's CDR. Despite the distorting effect that deferments, forbearances, and income-driven repayment plans have on CDRs, however, a decision by the Department, by rule or otherwise, to change how borrowers using these benefits are counted in an institution's CDR, so as to better measure institutional and program quality or student outcomes, would not, in our judgment, survive the legal challenges that would be certain to follow, absent a change in the CDR statutory definition.

Examining repayment in another context, the Department developed a program-based repayment rate metric as part of its recent Gainful Employment (GE) regulations. A federal court vacated several provisions of the GE regulations last year and the regulations are still involved in ongoing litigation, but the content of the published regulations address your request for information. The GE repayment rate metric in the regulations did not treat borrowers in forbearance or deferment as actively repaying their loans. The regulations also limit the dollar amount of loans in negative amortization or with interest-only payments included in the numerator of the rate to no more than 3 percent of the total amount of the original outstanding principal balance included in the denominator of the rate.

In addition, historically, given the significant negative consequences of default for borrowers and the taxpayer, the Department has encouraged institutions to be actively engaged with their borrowers so they transition successfully to repayment and avoid default. The HEA requires institutions to conduct exit counseling with their borrowers that includes information on debt management strategies designed to facilitate repayment, on forbearance, deferment, and available loan repayment plans, and on the consequences of default. The Department provides information to institutions, at their request, on former students who borrowed for attendance at the institution and who are significantly delinquent in repayment of their Direct Subsidized and Unsubsidized Loans to enable those institutions to reach out and assist those borrowers in addressing their repayment problems. Some institutions have also implemented debt management programs with their students in an effort to reduce unnecessary borrowing and to provide ongoing counseling that encourages successful borrower repayment. The Department supports many of these institutional efforts. However, I agree that institutional debt management or default aversion programs that focus only on a borrower securing short-term relief through forbearance is not a satisfactory debt management program and may benefit the institution more than the borrower. Using its authority to administer the Direct Loan Program, the Department will work with institutions and others to identify best practices and provide guidance to institutions to develop optional debt management and default aversion programs. We will also examine whether the Department should mandate certain core components and prohibit certain practices through regulation in order to protect borrowers.

In addition to the information presented in the recent "For-Profit Higher Education: The Failure to Safeguard the Federal Investment and Ensure Student Success" report, the Department received evidence of forbearance-only default aversion practices by at least one institution and its third-party agent during the 2012 Loans Negotiated Rulemaking public meetings. Concerns over these practices resulted in the Federal and non-Federal negotiators' agreement to modify the forbearance regulations in the Direct Loan and Federal Family Education Loan (FFEL) programs to limit any forbearance granted based on a borrower's oral request and affirmation to a 120-day period and to prohibit consecutive 120-day forbearance periods. This proposed change to the forbearance provisions in the Direct Loan and FFEL program regulations is expected to be published in a Notice of Proposed Rulemaking for public comment sometime in the summer of 2013. We believe this will deter, at least in part, the use of successive forbearance periods based on a borrower's oral request to cover the cohort period.

The Department also attempted outreach with some former students of one for-profit school to question borrowers about the institution's practices. Conversations with these former students support your assertion that some institutions are aggressively pursuing their former students to compel them to request forbearance from their loan servicer. According to the students' accounts, institutional representatives assisted them in completing forbearance request forms or initiated three-way calls with loan servicers to facilitate the borrower's oral request for forbearance. With the exception of one borrower, all borrowers indicated they were undergoing financial difficulties and clearly would have qualified for forbearance and other available program benefits if they had independently requested assistance from the loan servicer. Many of the borrowers expressed the view that they were pressured or "forced" to apply for forbearance and were not made aware of other options, such as deferment or the income-based repayment plan. One borrower stated that she was current in her payments, but was offered a $25 gift card to complete the forbearance process.

As you know, under HEA section 435(m)(2)(B), a loan on which a payment is made by the school, the school's owner, or the school's agent, contractor, employee, or any other entity or individual affiliated with the school in order to avoid default by the borrower, must be considered a default for purposes of calculating the school's CDR. Additionally, section 435(m)(3) directs the Secretary to prescribe regulations designed to prevent an institution from evading the consequences of its default rate through the use of such measures as branching, consolidation, a change of ownership or control, or other similar changes to the institution's structure and identity. The CDR evasion prevention regulations are found at 34 C.F.R. §§ 668.188 and 668.207. Although the HEA currently provides the Department authority to prevent an institution from evading its CDR through merger and other structural changes, it does not include the "default management" activities described in your letter as an impermissible evasion under the HEA.

With regard to potential CDR manipulation through OPE-ID consolidations, the evasion regulations at 34 C.F.R. §§ 668.188 and 668.207 prevent an institution from evading the consequences of its CDR through a merger or other structural change that reduces the number of its OPE-IDs. Also, merger and change of ownership applications receive a heightened level of review and scrutiny by the Department, which includes a review of the Title IV participation and history of each school involved in the merger. Among many other factors, the audit and program review history, financial statements, and default rate of each school are examined. Input is specifically requested from Federal Student Aid's (FSA) program review compliance staff and its Debt Management and Default Prevention and Management Groups, the Department's Office of Inspector General and its Office of the Chief Financial Officer, State agencies and the institution's accrediting agency. The Department's extensive review process recently resulted in one potential merger being delayed and another application being withdrawn. Additionally, under the regulations at 34 C.F.R. §668.16(m) (as revised in light of restrictions placed on the Department in 2008 under HEA section 435(a)(3)), institutions may be placed on provisional certification at least one year before they are subject to sanctions for high CDRs under the statute. Notwithstanding our current review process for mergers and consolidations, and our authority to provisionally certify an institution, we will continue to examine any increased activity in this area, and the timing of that activity, to ensure that the Department's regulations are using the available statutory authority to effectively safeguard against CDR evasion.

Finally, your letter expresses concern that mergers could be used to avoid loss of eligibility under the "90/10" requirement in HEA § 487 (a)(24). While the HEA's provisions regarding that requirement are very specific (see HEA section 487(d)), nothing in statute or regulations currently prevents companies that own more than one institution from applying for Department consent to combine them, or from applying to shift additional locations from one institution to another, in order to maintain eligibility under those provisions.

I appreciate you and your colleagues sharing with us your concerns about activities you believe undermine the integrity of the Title IV federal student aid programs which are so vital to this nation's citizens. The Department would be pleased to provide you and your colleagues with a briefing on our current efforts and to discuss future efforts we may want to undertake to increase accountability and maintain the integrity of the programs. To arrange such a briefing, please have your staff contact Kim Zarish-Becknell of the Department's Office of Legislation and Congressional Affairs at 202-401-0020.

Sincerely,

Arne Duncan