Florida TaxWatch

The Value of Florida's Higher Education System & the US Department of Education's Proposed Student Loan Forgiveness Rules

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Florida TaxWatch

106 North Bronough Street, Tallahassee, FL 32301 floridataxwatch.org o: 850.222.5052 f: 850.222.7476

Dear Fellow Taxpayer:

Student loan debt is a significant and growing problem for the millions of college graduates who are in danger of defaulting each year. In Florida, more than one-half of our graduates have student loan debt, averaging almost $24,000.

The new federal Borrower Defense Against Repayment Rule, effective July 1, 2017, is designed to protect student loan borrowers from misleading, deceitful, and predatory practices of higher education institutions participating in federal student financial assistance programs. Under the new Rule, the U.S. Department of Education is authorized to relieve a student of any obligation to repay a loan if the student can demonstrate that there was a substantial misrepresentation by the school, and that the student reasonably relied on that misrepresentation when deciding whether to attend, or keep attending, the school.

As written, the new Rule is an overreach by the U.S. Department of Education and will likely encourage frivolous claims by student borrowers to discharge their student loans. Granting these frivolous claims and discharging student loans could leave taxpayers on the hook for hundreds of millions of dollars of discharged loans. The financial liability to Florida taxpayers will be substantial, as the costs of discharged student loans will be borne by the institutions, loan guaranty agencies, the federal government, and (ultimately) the taxpayers.

In this paper, Florida TaxWatch looks at the economic impacts of the new Borrower Defense Against Repayment Rule on Florida's higher education institutions and on Florida taxpayers. It is my hope that this will stimulate discussion and cause officials to revisit the rules to make sure they are fair to both the student borrowers seeking debt relief and the institutions from which relief is sought.

Sincerely,

Dominic M. Calabro

Dominic M. Calabro
President & CEO

Executive Summary

Student loan debt is a significant and growing problem for the millions of college graduates who are in danger of defaulting each year. Nationwide, approximately 40 million loans totaling more than $1 trillion are guaranteed or held by the federal government.

Almost seven in 10 seniors (68 percent) who graduated from public and nonprofit colleges in 2015 had student loan debt, with an average of $30,100 per borrower. Statewide average debt levels for the Class of 2015 range from $18,850 (Utah) to $36,101 (New Hampshire). The share of graduates with debt ranges from 41 percent (Utah) to 76 percent (New Hampshire). Florida is considered to be a "low-debt" state, with an average debt level of $23,379 and 53 percent of graduates with debt.

In November 2016, the U.S. Department of Education (Department) published its final Borrower Defense to Repayment Rule (Rule). The Rule, which will take effect on July 1, 2017, permits the Department to discharge student loans, thereby relieving the student of any obligation to repay the loan, if the borrower can demonstrate: (1) that there was a substantial misrepresentation by the school; and (2) that the borrower reasonably relied on that misrepresentation when deciding whether to attend, or keep attending, the school.

Critics of the Rule have expressed concern that the standard for misrepresentation is so broad that borrowers will have nothing to lose by claiming a borrower defense, even if they are gainfully employed and happy with their college experience. It is doubtful that the institutions or taxpayers could shoulder this burden if thousands of students or graduates start requesting that their loans be discharged.

Costs will be borne by the institutions, loan guaranty agencies, the federal government, and (ultimately) the taxpayers. Changes to an institution's business practices, revised advertising and marketing materials, and employee training will have costs; however, the greatest cost will be the cost to the taxpayers as a result of student borrowers who are successful in their borrower defense claims. Although the Rule was drafted with the for-profit sector in mind, many public and private not-for-profit institutions will also experience financial repercussions.

The financial liability to Florida taxpayers under the Rule is substantial; all told, based on the Department's estimates of financial impacts, the financial liability to Florida taxpayers could be as little as $131.36 million over the next decade or as much as $2.81 billion. This excludes the costs of the accompanying administrative and legal burden placed on the institutions which, although indeterminate, will be substantial. TaxWatch estimates that, based on the Department's estimates of the financial impacts over the 2017-26 loan cohorts, every one percent of student debt discharged by the Department under the Rule will cost Florida taxpayers an additional $10.92 million.

To mitigate the financial liability to Florida taxpayers, Florida TaxWatch recommends:

1. The Department should delay the July 1, 2017 effective date of the Borrower Defense Against Repayment Rule pending further study and revision, as recommended below;

2. The Department should "take a step back" to more clearly understand the role socioeconomic factors play in student loan defaults. The Department should amend the Borrower Defense Against Repayment Rule to make sure that it is financially risky institutions and institutions that defraud students, and

not the population of disadvantaged students who attend them, that are penalized;

3. The Department should amend the Borrower Defense Against Repayment Rule to limit actions against institutions to those cases where there is clear evidence of intent to defraud;

4. The Department should amend the Borrower Defense Against Repayment Rule to include an element of intent or distinguish between intentional and unintentional acts. Further, the standard should be "clear and convincing evidence" that the institution is attempting to defraud prospective or enrolled students;

5. In order to help students make well-informed decisions about where to go to college and their financial aid use, the Department should amend the Borrower Defense Against Repayment Rule to require written warnings for prospective and enrolled students at all types of institutions with poor repayment rates. The protections under the Rule should be extended to students at all types of institutions;

6. The Department should amend the Borrower Defense Against Repayment Rule to provide institutions a credible appeals process. Absent an appeals process, the Rule should provide institutions an opportunity to challenge the Department official's decision during any related recoupment action; and

7. The Department should amend the Borrower Defense Against Repayment Rule to make sure it is fair to both the student borrowers seeking debt relief and the institutions from which relief is sought.

Introduction

Higher education is one of Florida's most important economic development tools. The state's workforce is trained by a variety of post-secondary institutions, each of which focuses on different types of students and has different methods of funding its operations – but all of which will be affected by the U.S. Department of Education's (Department's) new student loan forgiveness proposal.

Generally, the system involves three types of institutions – private not-for-profit colleges and universities, for-profit colleges and universities, and taxpayer-funded "public" colleges and universities. Each of these types of institutions has a role in educating Florida's diverse population and has an economic impact on its community and the state.

Student loan debt is a significant and growing problem for the millions of college graduates who are in danger of defaulting each year. Nationwide, American families have taken on more than $1.3 trillion in student loan debt—more than what they borrow with credit cards or to buy cars.[1] The current borrower default rate nationwide is 11.3 percent, with 593,182 borrowers in default.[2] In Florida, the current borrower default rate is 14.1 percent, with 43,498 borrowers in default.[3]

The Department recently proposed rules allowing current and former students to file claims for loan forgiveness if they believe their school made a "substantial misrepresentation" regarding the school or its programs. These new rules apply to all institutions

1 Richard Vedder, Justin Strehle, "The Diminishing Return of a College Degree," Wall Street Journal, June 4, 2017.

2 U.S. Department of Education, "Comparison of FY 2013 Official National Cohort Default Rates to Prior Two Official Cohort Default Rates Calculated August 6, 2016, retrieved from www2.ed.gov/offices/OSFAP/defaultmanagement/schooltyperates.pdf, April 10, 2017.

3 U.S. Department of Education, "FY 2013 3-Year Official Cohort Default Rates by State/Territory National Calculated August 6, 2016, retrieved from www2.ed.gov/offices/OSFAP/defaultmanagement/staterates.pdf, April 10, 2017.

of higher education. Should a student loan be forgiven under the new rules, the institution shoulders the burden of repaying the loan. For public colleges and universities, the obligation to repay the loans lies with the taxpayers. The Department estimates that the proposed new rules would cost U.S. taxpayers up to $43 billion over the next 10 years.[4]

The purpose of this independent research study is to examine the economic impacts of the Department's Borrower Defense Against Repayment Rule on Florida's higher education institutions and on Florida taxpayers.

The Roles of Colleges and Universities

Public Colleges and Universities

Most public colleges and universities were founded by state governments to provide residents an opportunity to receive public college education. State governments generally pay most of the operating costs of public colleges and universities, which permits public colleges and universities to offer lower tuition.[5]

Public colleges and universities and colleges usually have a large number of students. Florida is home to three of the 10 largest universities in the U.S. The University of Central Florida, with a 2015-16 student enrollment of 63,016, is the largest university in the U.S. Florida International University, with a 2015-16 student enrollment of 54,058, ranks fourth, and the University of Florida, with a 2015-16 student enrollment of 52,519, ranks fifth.[6]

Public colleges and universities generally offer a wide choice of majors. In a single large public university, undergraduates will be enrolled in academic programs ranging from traditional liberal arts to highly specialized technical fields.[7] Class sizes also tend to be larger at public colleges and universities, especially in lower-division courses.

The State University System of Florida consists of 12 public universities, each of which has a distinct mission and a commitment to excellence in teaching, research, and public service. To promote the alignment of the State University System degree program offerings and the economic development and workforce needs of the state, the Board of Governors maintains a list of Programs of Strategic Emphasis that are classified into the following categories:

- Science, Technology, Engineering, and Mathematics (126 disciplines);
- Health Professions (50 disciplines);
- Global Competitiveness (24 disciplines);
- Education (38 disciplines); and
- Gap Analysis (10 disciplines).

The Board of Governors' 2025 System Strategic Plan calls for 50 percent of Bachelor's degrees and 60 percent of Graduate degrees to be awarded within these Programs of Strategic Emphasis.[8]

The Florida College System (FCS) is a network of 28 public colleges serving nearly a million Floridians. The FCS is the primary point of access to higher education in Florida, enrolling returning adult students and approximately 65 percent of recent high school

4 The Hill, "Obama's Student Loan Forgiveness Proposal Misses Target," June 17, 2016.

5 Peterson's, "Public University Versus Private College," retrieved from www.petersons.com/college-search/public-university-vs-private.aspx#/sweeps-modal, April 10, 2017.

6 World Atlas, "Largest Universities in the United States By Enrollment," retrieved from http://www.worldatlas.com/articles/largest-universities-in-the-united-states.html.

7 Supra, see footnote 5.

8 Florida Board of Governors 2025 Strategic Plan. http://www.flbog.edu/pressroom/_doc/2025_System_Strategic_Plan_Amended_FINAL.pdf

graduates.[9] Member institutions offer high-quality, affordable academic and career education programs designed to maximize student learning and success, develop a globally competitive workforce and respond rapidly to diverse state and community needs.[10]

In the 2013-14 academic year, 4,774,586 college degrees were conferred in the U.S., including 2,990,840 (62.6 percent) degrees conferred by public institutions. This includes:[11]

- Certificates --- 576,258 (19.3 percent);
- Associate's --- 793,180 (26.5 percent);
- Bachelor's --- 1,186,397 (39.6 percent);
- Master's --- 346,101 (11.6 percent); and
- Doctor's --- 88,904 (3.0 percent).

Private Not-For-Profit Colleges and Universities

Independent (private, not-for-profit) colleges and universities do not receive operational subsidies from the state of Florida like public universities. Instead, they operate with tuition revenues and institutional funds. This allows flexibility and individuality to flourish as they educate diverse student populations and collaborate to accommodate their community's needs.[12]

Private not-for profit colleges and universities tend to be much smaller than public colleges universities, many of which have enrollments of only a few thousand students. Private colleges offer a smaller range of majors, but often have a particular academic focus. Some private colleges may emphasize the liberal arts or the fine arts, for instance, while others focus on engineering and computer science.[13] Class sizes tend to be smaller at private not-for profit colleges and universities.

The Independent Colleges and Universities of Florida (ICUF) Association includes 30 non-profit Florida-based Southern Association of Colleges and Schools (SACS)-accredited institutions. ICUF institutions offer undergraduate, graduate, first-time professional and continuing education programs throughout Florida. ICUF enrolls more than 154,000 students, which represents one-third of the students who attend four-year colleges and universities in Florida.[14] Campus annual enrollments range from 200 students (Beacon College) to 26,000 students (Nova Southeastern University) and are diverse in their students, communities and missions.[15] With more than 100 main and satellite campuses, and hundreds of on-line degree programs, ICUF institutions have an annual economic impact of more than $5 billion, making them a powerful education and economic tool in Florida.[16]

In the 2013-14 academic year, 4,774,586 college degrees were conferred in the U.S., including 1,042,544 (21.8 percent) degrees conferred by private not-for-profit institutions. This includes:[17]

- Certificates --- 30,730 (2.9 percent);
- Associate's --- 53,127 (5.1 percent);
- Bachelor's --- 544,213 (52.2 percent);
- Master's --- 333,580 (32.0 percent); and
- Doctor's --- 80,894 (7.8 percent).

9 The Florida College System, "The Florida College System 2015 Annual Report," retrieved from www.floridacollegesystem.com/sites/www/Uploads/Publications/FCSAnnualReport2015.pdf.

10 Ibid.

11 National Center for Education Statistics, "Degrees Conferred by Public and Private Institutions," retrieved from https://nces.ed.gov/programs/coe/indicator_cts.asp, April 10, 2017.

12 Independent Colleges and Universities of Florida, "An Independent Education," retrieved from http://www.icuf.org/newdevelopment/about-icuf/importance, April 10, 2017.

13 Supra, see footnote 5.

14 Independent Colleges and Universities of Florida, "An Independent Education," retrieved from http://www.icuf.org/newdevelopment/about-icuf/importance, April 10, 2017.

15 Ibid.

16 Ibid.

17 Supra, see footnote 11.

For-Profit Colleges and Universities

For-profit colleges have an important role to play in higher education. The existing capacity of nonprofit and public higher education is insufficient to satisfy the growing demand for higher education, particularly in an era of drastic cutbacks in state funding for higher education. Meanwhile, there has been an enormous growth in non-traditional students—those who either delayed college, attend part-time or work full-time while enrolled, are independent of their parents, or have dependents other than a spouse.[18]

For-profit colleges are responsible for awarding more than half of the associate degrees in computer science and information technology in the United States. That fills a major gap in the marketplace for skilled labor. In the 2013-14 academic year, 4,774,586 college degrees were conferred in the U.S., including 741,202 (15.5 percent) degrees conferred by for-profit institutions. This includes:[19]

- Certificates --- 362,305 (48.9 percent);
- Associate degrees --- 157,057 (21.2 percent);
- Bachelor's --- 139,204 (18.8 percent);
- Master's --- 74,794 (10.1 percent); and
- Doctorate --- 7,792 (1.0 percent).

Characteristics of Student Borrowing

The research literature classifies student borrowers as either "traditional" or "non-traditional." Traditional borrowers are undergraduate or graduate borrowers from four-year public and private not-for-profit institutions. Traditional borrowers are more likely to come from higher-income families, more likely to start college in their late teens - soon after graduating high school, more dependent on their parents, and more likely to have parents who graduated from college. Traditional borrowers make up a large share of federal borrowers and loan amounts.

Non-traditional borrowers, however, are even more likely to borrow to finance their higher education. They generally borrow larger amounts of money, and also supplement federal borrowing with borrowing from non-federal sources, which tend to have less favorable terms. Non-traditional borrowers are more likely to be enrolled in certificate or associate's degree programs, more likely to be older, female, and minority students, more likely to be single parents, and have the highest average number of dependents. They are typically financially independent and not likely to depend on family members for financial support. Non-traditional students have lower average household incomes and are less likely to have parents who completed college. By 2014, non-traditional borrowers made up almost 40 percent of all federal borrowers.[20]

In 2011–2012, 60 percent of certificate students who were enrolled at for-profit two-year institutions took out federal student loans during that year, compared with 10 percent at public two-year institutions. Of those who borrowed, the median amount borrowed by students enrolled in certificate programs at two-year for-profit institutions was $6,629, as opposed to $4,000 at public two-year institutions.[21]

Additionally, in 2011–12, 66 percent of associate degree students who were enrolled at for-profit institutions took out student loans, while only 20 percent of

18 For Profit Higher Education: The Failure to Safeguard the Federal Investment and Ensure Student Success.

19 Supra, see footnote 11.

20 Adam Looney and Constantine Yannelis, "A Crisis in Student Loans? How Changes in the Characteristics of Borrowers and in the Institutions They Attended Contributed to Rising Loan Defaults," Brookings Institution, September 2015, retrieved from www.brookings.edu/wp-content/uploads/2015/09/LooneyTextFall15BPEA.pdf, January 26, 2017.

21 National Postsecondary Student Aid Study (NPSAS) 2012. Unpublished analysis of restricteduse data using the NCES PowerStats tool, retrieved from www.gpo.gov/fdsys/pkg/FR-2016-11-01/pdf/2016-25448.pdf, January 03, 2017.

associate degree students who were enrolled at public two-year institutions did so. Of those who borrowed in that year, for-profit two-year associate degree enrollees had a median amount borrowed during that year of $7,583, compared with $4,467 for students at public two-year institutions.[22] These differences are due primarily to the fact that public institutions are government subsidized, while for-profit institutions are not and must charge higher tuition to cover the full costs of their operations and instructional services.

The Student Loan Default Problem

Defaulting on a federal student loan occurs when a borrower lets nine months pass without making a payment. The consequences of defaulting on a student loan can be severe. For a defaulted loan, the entire balance of the loan comes due and payable immediately. There are no more monthly bills or lower payment options. In addition, any interest outstanding at the time of default is added to the principal, increasing the overall loan balance. Collection costs are substantial, in some cases (e.g., Perkins Loans) as high as 40 percent.[23]

To illustrate, consider a student who takes out a $25,000 federal loan and defaults after nine months. Assuming this loan has a four percent interest rate, an additional $1,000 would be added to the balance in the form of capitalized interest. Any late fees would also be added to the balance. When the collection fees are added (assume 20 percent or $5,000), the borrower's $25,000 loan will have increased to $31,000 in just nine months.

22 Ibid.

23 Betsy Mayotte, "Understand the Consequences of Student Loan Default," U.S. News & World Report, March 4, 2015, retrieved from www.usnews.com/education/blogs/student-loan-ranger/2015/03/04/understand-the-consequences-of-student-loan-default.

As onerous as this scenario is, it gets worse. Federal student loan holders and the Department can garnish a borrower's tax refund without any type of court order or legal action, although they will notify the borrower ahead of time and give them the opportunity to appeal or resolve the default. If the borrower filed their taxes with a spouse, the spouse's portion of the refund will also be garnished and put toward your defaulted student loan.[24]

In general, defaulted student loans will be certified for tax offset after months of attempts to resolve the loan with the borrower with little or no response. The Department can refer a borrower's account to the U.S. Department of Treasury for collection by an offset of the borrower's federal (and in some cases state) tax returns. The Department of Treasury can withhold the entire amount of a borrower's tax refund to satisfy the debt that is owed. Once a loan is certified for offset, it's rare to have it removed unless and until the loan is either taken out of default or paid in full. A borrower's wages, Social Security and other benefits can also be garnished.[25]

In some states, borrowers with defaulted federal student loans may have their license to practice certain professions suspended or revoked. If all else fails, the U.S. Department of Justice may take legal action against a borrower with a defaulted federal student loan.

Almost seven in 10 seniors (68 percent) who graduated from public and private not-for-profit colleges and universities in 2015 had student loan debt, with an average of $30,100 per borrower. This represents a four percent increase from the average debt of 2014 graduates.[26] Almost one-fifth (19 percent) of

24 Ibid.

25 Ibid.

26 The Institute for College Access & Success, "Student Debt and the Class of 2015," retrieved from http://ticas.org/posd/map-state-data#.

the Class of 2015's debt nationally was comprised of non-federal loans, which provide fewer consumer protections and repayment options and are typically more costly than federal loans, and lower income students usually receive the worst loan rates and terms.[27] This can significantly affect a student borrower's ability to repay what they owe.

Statewide average debt levels for the Class of 2015 range from $18,850 (Utah) to $36,101 (New Hampshire). The share of graduates with debt ranges from 41 percent (Utah) to 76 percent (New Hampshire). Florida is considered to be a "low-debt" state, with an average debt level of $23,379 and 53 percent of graduates with debt.[28] For-profit colleges and universities are not included in these national and state averages.

The most recent nationally representative data are for 2012 graduates, and these data show that the vast majority from for-profit four-year colleges (88 percent) took out student loans. These students graduated with an average of $39,950 in debt --- 43 percent more than 2012 graduates from other types of four-year colleges.[29] This is not surprising in light of the high percentage of non-traditional students who elect to attend for-profit institutions.

Between 2000 and 2014, default rates among recent student loan borrowers rose to their highest levels in 20 years. Most of the increase in defaults is associated with borrowers at for-profit schools, two-year institutions, and (to a lesser degree) certain other non-selective institutions. These non-traditional borrowers experience higher rates of default in part because they are drawn from more disadvantaged backgrounds. In contrast, default rates have remained low among borrowers who attended most four-year public and non-profit private institutions and among graduate school borrowers—who collectively represent the vast majority of the federal loan portfolio.[30]

The "Defense Against Repayment" Rule

The Department last revised the borrower defense regulations more than two decades ago. Until recently, the use of the borrower defense regulations by the Department has been limited. What has triggered a change is the collapse of Corinthian Colleges, which has generated an unprecedented level of borrower defense claims activity.[31]

Corinthian was a publicly-traded for-profit higher education company with more than 100 campuses and more than 70,000 students. Allegations by former students that Corinthian aggressively marketed its courses, pressured students to borrow more money and incur more debt than they could handle, and falsified its employment statistics prompted a number of federal and state investigations and subsequent actions that led to Corinthian filing bankruptcy in 2014. This bankruptcy resulted in a large number of students seeking relief from their loan debt.

As of October 2016, the Department had received approximately 82,000 claims arising from alleged misrepresentations by Corinthian. Almost 16,000 of these claims, totaling more than $247 million, have been approved for discharge.[32] The closure of Corinthian campuses has generated more than 13,000 closed school discharge claims, of which 7,858 closed school discharges totaling approximately $103.1 mil-

27 Ibid.

28 Ibid.

29 Ibid.

30 Supra, see footnote 9.

31 U.S. Department of Education, "Student Assistance General Provisions, Federal Perkins Loan Program, Federal Family Education Loan Program, William D. Ford Federal Direct Loan Program, and Teacher Education Assistance for College and Higher Education Grant Program," 34 CFR Parts 30, 668, 674, 682, 685, and 686, RIN 1840–AD19, [Docket ID ED–2015–OPE–0103], November 1, 2016.

32 U.S. Department of Education, "Federal Student Aid Enforcement Report on Borrower Defense," retrieved from www2.ed.gov/documents/press-releases/borrower-defense-report.pdf, January 05, 2017.

lion have been approved.[33] Thousands more claims, both from former Corinthian students and from students at a number of other institutions, are pending a full review, and the Department expects to receive more as it continues to conduct outreach to potentially affected students.[34]

Corinthian is not the only private, for-profit institution to find itself in the crosshairs of the Department. Department investigations and subsequent actions forced ITT Technical Institute, a privately-owned trade school and university, to close its 130 campuses. ITT's closure left more than 40,000 students stranded, and made hundreds of millions of dollars of student loans eligible for discharge.[35]

In November 2016, the Department published its final Borrower Defense Against Repayment Rule. The Rule, which will take effect on July 1, 2017, permits Federal Direct Loans made to students after that date to be discharged, relieving the student of any obligation to repay the loan, under any of the following conditions:[36]

- There is a non-default, favorable contested judgment against the school, in a state or federal court or administrative tribunal, relating to the loan itself or to the educational services for which the loan was originally made;
- The borrower may ground a claim in breach of contract by the school, if the school has failed to perform its obligations under a contract with the student (including, but not limited to, enrollment agreements); or
- The borrower may ground a claim in substantial misrepresentation by the school.

33 Ibid.

34 Supra, see footnote 23.

35 Opinion, "Obama's For-Profit Execution," The Wall Street Journal, August 29, 2016, retrieved from www.wsj.com/articles/obamas-for-profit-execution-1472511905, January 05, 2017.

36 John Przypyszny and Jonathan Tarnow, "U.S. Department of Education Issues Final Rule on Borrow Defense to Repayment," The National Law Review, November 7, 2016.

It is this last condition that is the most controversial. In response to more than 10,000 comments on the proposed rule, the Department amended the definition of "misrepresentation" to include not only false or erroneous statements, but also misleading statements that have the likelihood or tendency to mislead under the circumstances. Omissions of information are also considered misrepresentations. Under this definition, a statement may be considered misleading even if it is true on its face.

Critics of the new rule point out that the decision whether to grant a defense to repayment claim and to discharge the student borrower's loan is made solely by the Department. Questions regarding Constitutional due process have been raised, since the new rule does not ensure schools would have the right to receive notice of all the evidence presented by a student borrower in borrower defense proceedings.[37]

Further, the standard to be used by the Department in determining whether to grant a defense to repayment claim and to discharge the borrower's loan is "preponderance of the evidence." To meet this burden of proof, a borrower would have to provide "just enough" evidence to make it more likely than not that the statement(s) made by the institution is a misrepresentation. This is a more lenient standard than "clear and convincing evidence," which would require the evidence provided by the borrower to be "highly and substantially" more probable than not likely to be true. The use of a more lenient standard raises the possibility of borrowers filing false claims.

It is important to note that there is no requirement that the borrower demonstrate any intent, or lack thereof, on the part of the institution to misrepresent. The borrower only needs to assert that there was a substantial misrepresentation by the school, and that the borrower reasonably relied on that mis-

37 Supra, see footnote 23.

representation when deciding whether to attend, or keep attending, the school. This raises the possibility of inadvertent errors or omissions by an institution or its employees serving as the basis for a borrower defense claim. This could lead to frivolous claims by borrowers and substantial financial liabilities for schools (and taxpayers).

There is also no provision that would permit an institution to appeal the Department's decision on any given claim. The new rule effectively permits the Department to serve as the prosecutor, the judge, the only source of appeal, and the entity tasked with executing judgment.

The Rule includes public and private not-for-profit colleges and universities as well. Although the dramatic increase in student loan default is associated with borrowers at proprietary schools, the outstanding loan balances from this sector make up a disproportionately smaller percentage of the total outstanding student loans.[38]

A 2015 Brookings Institution study[39] disaggregated National Student Loan Data System data in an attempt to better understand the causes of borrower defaults on student loans. Although the results were mixed, as much as 50 percent of the default rates could be explained by socioeconomic factors not caused by the type of institution that students attended.[40] Student borrowers from disadvantaged backgrounds with less money and less ability to get financial help from their family are more likely to experience difficulty repaying their student loans, independent of the quality of education they receive. The study suggests that proprietary institutions are being held accountable for factors that are beyond the quality of education they provide and beyond their ability to control.

The rule imposes additional financial responsibilities and additional disclosure requirements on proprietary schools. Institutions deemed by the Department to be "not financially responsible" are required to secure letters of credit and other financial protections. Further, institutions whose loan repayment rate falls below 50 percent must provide "plain language" warnings to enrolled and prospective students.

Financial Impacts

Costs associated with the Rule will be borne by the institutions, loan guaranty agencies, the federal government, and (ultimately) the taxpayers. Changes to an institution's business practices, revised advertising and marketing materials, and employee training will have costs; however, the greatest cost will be the cost to taxpayers as a result of borrowers who are successful in their borrower defense claims. Although the Rule was drafted with the for-profit sector in mind, many public and private not-for-profit institutions will also experience financial repercussions.

The Department acknowledges that uncertainty related to borrower defense makes estimating the budget impacts of the Rule difficult. Different scenarios produced a wide range of potential budget impacts, from $1.997 billion in the lowest impact scenario to $42.698 billion in the highest impact scenario over the next decade.[41] The financial impact over the 2017–2026 loan cohorts[42] is estimated to be $16.6 billion.[43]

38 Supra, see footnote 8.

39 Ibid.

40 Daniel R. Perez, "Public Interest Comment on the Department of Education's Proposed Rule," The George Washington University Regulatory Study Center, August 1, 2016, retrieved from https://regulatorystudies.columbian.gwu.edu/sites/regulatorystudies.columbian.gwu.edu/files/downloads/DPerez_Dept.Ed.-Direct-Loan-Program-8-2016.pdf, January 27, 2017.

41 Supra, see footnote 8.

42 A cohort reflects all loans originated in a given fiscal year.

43 Supra, see footnote 23.

Lowest Impact Scenario

The cost estimate for the Department's lowest impact scenario is $1.997 billion over the next decade. Dividing this amount by the population of the U.S. aged 18 years or older (presumably the age group that would have to repay the discharged loans) results in a minimum per U.S. taxpayer financial burden of $8.00.[44] Multiplying this amount by the population of Florida 18 years of age and older yields a total of $131.36 million.[45] Based upon the Department's cost estimates, student loans discharged under the new Rule will cost Florida taxpayers a minimum of $131.36 million over the next decade.

Highest Impact Scenario

The cost estimate for the Department's highest impact scenario is $42.698 billion over the next decade. Dividing this amount by the population of the U.S. aged 18 years or older (presumably the age group that would have to repay the discharged loans) results in a maximum per U.S. taxpayer financial burden of $171.14.[46] Multiplying this amount by the population of Florida 18 years of age and older yields a total of $2.81 billion.[47] Based upon the Department's cost estimates, student loans discharged under the new Rule will cost Florida taxpayers a maximum of $2.81 billion over the next decade.

2017–2026 Loan Cohorts

The Department estimates that the financial impact over the 2017–2026 loan cohorts to be $16.6 billion. Dividing this amount by the population of the U.S. aged 18 years or older (presumably the age group that would have to repay the discharged loans) results in a maximum per U.S. taxpayer financial burden of $66.53.[48] Multiplying this amount by the population of Florida 18 years of age and older yields a total of $1.09 billion.[49] Based upon the Department's cost estimates for this cohort, student loans discharged under the new Rule will cost Florida taxpayers $1.09 billion over the next decade.

As protection against possible economic injury, the Department requires collateral in the form of letters of credit. In the case of Corinthian, the Department continued to raise the amount of collateral needed until Corinthian could no longer remain financially viable and closed its campus, leaving taxpayers on the hook for paying hundreds of millions of dollars in discharged loans.

The actual financial impact will depend in large part on how much the Department can recover from institutions whose conduct gave rise to the claims. Using the Department's estimates of the financial impacts of the 2017–2026 loan cohorts, every one percent of student loans discharged under the new Rule will cost Florida taxpayers approximately $10.92 million over the next decade.

Critics of the Rule have expressed concern that the standard for misrepresentation is so broad that borrowers will have nothing to lose by claiming a borrower defense, even if they are gainfully employed and happy with their college experience. It is doubtful that that the institutions or taxpayers could shoulder this burden if thousands of students or graduates start requesting that their loans be discharged.

44 $1,997,000,000 divided by 249,485,228 aged 18 years or older = $8.00.

45 $8.00 X 16,420,144 Floridians 18 years of age or older = $131,361,152.

46 $42,698,000,000 divided by 249,485,228 aged 18 years or older = $171.14.

47 $171.14 X 16,420,144 Floridians 18 years of age or older = $2,810,215,715.

48 $16,600,000,000 divided by 249,485,228 aged 18 years or older = $66.53.

49 $66.53 X 16,420,144 Floridians 18 years of age or older = $1,092,432,180.

Conclusions and Recommendations

Student loan debt is a significant and growing problem for the millions of college graduates who are in danger of defaulting each year. Since the beginning of the new millennium, default rates among recent student loan borrowers have risen to their highest levels in 20 years. Most of the increase in defaults is associated with borrowers at proprietary (for-profit) schools, two-year institutions, and (to a lesser degree) certain other non-selective institutions.

TaxWatch understands and supports the Department's intent to require financially risky institutions to take responsibility for losses to the government for discharges of and repayments for federal student loans; however, the Borrower Defense Against Repayment Rule could have unintended consequences for Florida taxpayers.

One such unintended consequence is the potential regressive effect of the rules on access to higher education by disadvantaged and non-traditional students. The closure of proprietary institution campuses in Florida would leave thousands of disadvantaged and non-traditional students with limited options --- if they are unable to gain admittance to programs and classes at public and private not-for-profit colleges and universities, then they may no other option for getting a post-secondary education.

For those that remain open, there is a risk of raising admission standards to make sure those who are admitted are only those who are more likely to repay their student loans. Exempting non-proprietary institutions from the additional financial responsibilities and additional disclosure requirements may result in a disproportionate share of the rule's costs being borne by institutions that can least afford them.

A second unintended consequence is the potential financial liability that would be foisted upon Florida taxpayers. Although uncertainty related to borrower defense makes estimating the budget impacts of the new rules difficult, Florida taxpayers will be required to pay their fair share of discharged student loans. This excludes the costs of the accompanying administrative and legal burden placed on the institutions which, although indeterminate, will be substantial.

Consider the following scenario --- a student borrows money to attend and graduate from a career training program at one of Florida's public colleges or universities. According to the Department's 2017 debt-to-earnings report, all of Florida's public career training programs received a passing score, demonstrating that these programs do offer value to students and provide their graduates a reasonable return on their investment. Based upon this, there is little reason to believe the graduate will default on his/her loan.

There is also little to discourage the graduate from then filing a frivolous claim with the Department to discharge the loan under the Borrower Defense Against Repayment Rule. The risk for the graduate borrower is de minimis. The graduate borrower only needs to find some unintentional error or omission that meets the definition of "misrepresentation." Even statements that are true on their face may be considered to be "misrepresented" under the new rule.

The graduate borrower has no obligation to demonstrate any intent, or lack thereof, on the part of the institution to misrepresent. The borrower only needs to assert that there was a substantial misrepresentation by the school, and that the borrower reasonably relied on that misrepresentation when deciding whether to attend, or keep attending, the school.

The decision whether to grant a defense to repayment claim and to discharge the borrower's loan will be made solely by the Department. The standard to be used by the Department is "preponderance of the evidence," which is more lenient than the "clear and convincing evidence" standard used in most civil proceedings. Under the preponderance of evidence standard, the borrower only needs to provide "just enough" evidence to make it more likely than not that the statement(s) made by the institution is a misrepresentation.

Finally, there is no provision that would permit an institution to appeal the Department's decision on any given claim. The new rule establishes the Department as prosecutor, judge, jury and executioner.

Now, imagine this scenario times the thousands of student borrowers who may take advantage of the liberal rule provisions and file frivolous claims to have their student loans discharged. TaxWatch estimates that every one percent of student debt discharged by the Department under the Rule will cost Florida taxpayers between $131.36 million and $2.81 billion or more over the next decade.

Having said all this, the Borrower Defense Against Repayment Rule should be fair to both the student borrowers seeking debt relief and the institutions from which relief is sought, and TaxWatch is concerned that the Rule, as written, is unfair.

To mitigate the financial liability to Florida taxpayers, Florida TaxWatch recommends:

1. The Department should delay the July 1, 2017 effective date of the Borrower Defense Against Repayment Rule pending further study and revision, as recommended below.
2. The Department should "take a step back" to more clearly understand the role socioeconomic factors play in student loan defaults. The rule should be amended as needed to make sure that it is financially risky institutions and institutions that defraud students, and not the population of disadvantaged students who attend them, that are penalized.
3. The Department should amend the Borrower Defense Against Repayment Rule to limit actions against institutions to cases where there is clear evidence of intent to defraud.
4. The Department should amend the Borrower Defense Against Repayment Rule to include an element of intent or distinguish between intentional and unintentional acts. Further, the standard should be "clear and convincing evidence" that the institution is attempting to defraud prospective or enrolled students.
5. In order to help students make well-informed decisions about where to go to college and their financial aid use, the Department should amend the Borrower Defense Against Repayment Rule to require written warnings for prospective and enrolled students at all types of institutions with poor repayment rates. The protections under the Rule should be extended to students at all types of institutions.
6. The Department should amend the Borrower Defense Against Repayment Rule to provide institutions a credible appeals process. Absent an appeals process, the Rule should provide institutions an opportunity to challenge the Department official's decision during any related recoupment action.
7. The Department should amend the Borrower Defense Against Repayment Rule to make sure it is fair to both the student borrowers seeking debt relief and the institutions from which relief is sought.

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As an independent, nonpartisan, nonprofit taxpayer research institute and government watchdog, it is the mission of Florida TaxWatch to provide the citizens of Florida and public officials with high quality, independent research and analysis of issues related to state and local government taxation, expenditures, policies, and programs. Florida TaxWatch works to improve the productivity and accountability of Florida government. Its research recommends productivity enhancements and explains the statewide impact of fiscal and economic policies and practices on citizens and businesses.

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RESEARCH TEAM

LEADERSHIP

Dominic M. Calabro

Robert E. Weissert, Esq.

PROJECT TEAM

Bob Nave

Chris Barry

CONTRIBUTORS

Elle Piloseno

Kurt Wenner

Kyle Baltuch

Alex Foster

Erin McCord

Patrick Mas

TaxWatch research is done under the direction of Dominic M. Calabro, President, CEO, Publisher & Editor.

The findings in this Report are based on the data and sources referenced. Florida TaxWatch research is conducted with every reasonable attempt to verify the accuracy and reliability of the data, and the calculations and assumptions made herein. Please feel free to contact us if you feel that this paper is factually inaccurate.

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106 N. BRONOUGH ST., TALLAHASSEE, FL 32301 O: 850.222.5052 F: 850.222.7476