FINANCIAL BAND-AID: REACTIONARY FIXES TO FEDERAL FAMILY EDUCATION LOAN PROGRAM INDUCEMENT GUIDELINES SOLVE SOME PROBLEMS, RAISE OTHERS

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INTRODUCTION

In 1848, Horace Mann proclaimed that "[e]ducation . . . beyond all other devices of human origin, is a great equalizer of the conditions of men,—the balance wheel of the social machinery. . . . [I]f this education should be universal and complete, it would do more than all things else to obliterate factitious distinctions in society."[1] Access to higher education, however, is at times limited by the high cost of obtaining an education.[2] Congress sought to break down that cost barrier by enacting the Higher Education Act of 1965 (HEA) to provide greater accessibility to financial resources for postsecondary and higher education.[3]

Today, rising tuition rates challenge the effectiveness of the HEA's student loan programs. In the past thirty years, tuition at America's colleges and universities increased nearly three hundred percent.[4] As a result, parents and students are

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1. HORACE MANN, SEC'Y OF MASS. STATE BD. OF EDUC., TWELFTH ANNUAL REPORT OF HORACE MANN AS SECRETARY OF MASSACHUSETTS STATE BOARD OF EDUCATION (1848), *available at* http://www.tncrimlaw.com/civil_bible/horace_mann.htm.

2. *See* Edward M. Kennedy, *Grant Access to Higher Education*, BOSTON GLOBE, Feb. 15, 2007, at A11. Senator Kennedy maintains, "400,000 qualified students a year don't attend a four-year college because they can't afford it." *Id.*

3. *See generally* Higher Education Act of 1965, Pub. L. No. 89-329, 79 Stat. 1219 (codified as amended at 20 U.S.C. §§ 1001–1140 (2000 & Supp. 2005)).

4. Mindy Fetterman & Barbara Hansen, *Young People Struggle to Deal with Kiss of Debt*, USA TODAY, Nov. 20, 2006, at 1A.

> The average price of college has grown much faster than the rate of inflation. Average annual tuition at public four-year colleges and universities is $5,836 in 2006–07, up 268% from 1976–77, according to the U.S. Education Department and the National Center for Education Statistics. Private college tuition is up 248% to $22,218 a year.

Id.

forced to borrow more to finance higher education, a phenomenon that catapulted student lending into an $85 billion a year industry.[5] The industry's rapid growth led to a "battle for dominance" among private lenders seeking to increase loan volume under the federally-backed Federal Family Education Loan (FFEL) Program, which lenders view as a low risk, high profit lending segment.[6]

As a result of increasing tuition and a more complex borrowing environment, the student loan process is increasingly difficult for students and parents to navigate. Financial aid offices serve a vital role in helping parents and students plot a course through this increasingly complex lending environment by providing borrowers with impartial information related to loan products.[7] Because private-based aid is increasingly necessary to help borrowers close the gap between tuition rates and federal lending caps, institutions often scan the marketplace of private lenders to ensure that borrowers receive as many benefits as possible.[8] Financial aid offices distill this information for borrowers based on the holistic evaluation of several criteria, including waiver of fees, variety of repayment options, competitiveness of interest rates, superior customer service, efficiency of technology and processing, the stability and longevity of lenders, and other factors.[9]

This process, which is typically very effective, is capable of breaking down if it becomes influenced by conflicts of interest. Financial aid offices normally prevent such conflicts by serving as gatekeepers. In limited instances, however, lenders attempting to get the upper hand in the increasingly competitive student lending industry engaged in questionable bargaining practices with a handful of institutions.[10] In these situations, lenders exploited ambiguities in the FFEL Program's statutory and regulatory framework, poor oversight and guidance, and

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5. Jonathan D. Glater & Karen W. Arenson, *Lenders Sought Edge Against U.S. in Student Loans*, N.Y. TIMES, Apr. 15, 2007, at A1 (noting that student loan volume rose "above $85 billion in 2005–06 from just over $30 billion 10 years earlier").

6. *Id.* The FFEL Program is part of the Higher Education Act of 1965. Pub. L. No. 89-329, 79 Stat. 1219 (codified at 20 U.S.C. §§ 1071–1087-4 (2000)). See *infra* notes 16–20 and accompanying text, for a more complete description of the FFEL Program.

7. *See* Haley Chitty, *Preferred Lenders: Setting the Record Straight*, U. BUS. (May 2007), http://www.universitybusiness.com/viewarticle.aspx?articleid=766.

8. *See* Tara Bahrampour, *Grants Help Fill Tuition Gap*, WASH. POST, Oct. 11, 2004, at B5; *see also* Clay Holtzman, *Student Borrowing Swells to Fill Gap*, PUGET SOUND BUS. J., Dec. 8, 2006, *available at* http://www.bizjournals.com/seattle/stories/2006/12/11/story2.html. Additionally, Chitty observes that federal loan limits have increased only modestly in the past decade for most borrowers and have not increased at all for upper-class and graduate students. *See* Chitty, *supra* note 7.

9. *See* Nat'l Ass'n of Student Fin. Aid Adm'rs, *Guide to Developing a Preferred Lender List*, 15 MONOGRAPH 1, 2–4 (May 2005), *available at* http://www.nasfaa.org/subhomes/MediaCenter/monograph15.pdf.

10. *See, e.g.*, Press Release, Edward M. Kennedy, U.S. Senate, Kennedy, Durbin Introduce Bill to Prevent Exploitation of Students by Private Lenders (Feb. 1, 2007), *available at* http://kennedy.senate.gov/newsroom/press_release.cfm?id=aba816bf-d7be-4d09-8f17-6f1457b35d4b; s*ee also* David Armstrong, *Trade Group Saw Possible Conflicts in Student Loans*, WALL ST. J., Apr. 11, 2007, at A1; Glater & Arenson, *supra* note 5.

lax enforcement to structure dubious arrangements with institutions.[11] Critics allege that such lender-institution relationships create an appearance of conflict of interest, undermine financial aid offices in their performance of their gate keeping function, and increase the risk of illegal lender inducements.[12]

As these potential weaknesses became highly publicized through prominent state investigations and media frenzy, Congress and the Department of Education ("Department") took action to implement reforms aimed at eliminating the potential for such conflicts.[13] The resulting reform measures achieve the noble goal of increasing transparency in the student lending process; however, the reactionary nature of the reform effort, often characterized by exaggerated press accounts and political rhetoric, left many unexamined and unintended consequences.[14] These potential consequences include increased costs for borrowers, decreased availability of grant money, reduced product offerings, and less comprehensive service.[15] With that background in mind, this Note examines reforms at the federal level and discusses the resulting impact on lenders, institutions, and borrowers.

First, the Note explores the historical legal and regulatory environment surrounding the FFEL Program and examines the shortcomings of that regime, including the lack of clarity and guidance on what constituted a prohibited inducement and a lack of consistent oversight and enforcement. Second, the Note explores the genesis of the federal reform effort. Third, the Note surveys prohibited inducements and preferred lending arrangements, two particular problem areas in the pre-reform regime. This discussion includes background information on conflict of interest issues, discusses current and pending reform measures, and analyzes potential deficiencies in these measures. Finally, this Note provides a brief overview of the potential impact that reform measures may have on institutional policies and procedures.

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11. *See, e.g.*, Megan Barnett et al., *Big Money on Campus*, U.S. NEWS & WORLD REPORT, Oct. 29, 2003, at 30. Lenders used various inducements directly or indirectly aimed at increasing loan volume, including financial arrangements with institutions and/or the provision of gifts, services, or other benefits to institutions and financial aid office employees. See *infra* Part III.A, for a more complete discussion.

12. *See, e.g.*, Press Release, Edward M. Kennedy, *supra* note 10.

13. *See infra* notes 68–72 and accompanying text (discussing the New York Attorney General Office's investigation of student lending practices and subsequent federal action aimed at avoiding disparate state regulations).

14. *See, e.g.*, Chitty, *supra* note 7. "Media reports suggest that the preferred lender list is the result of an 'unholy union' between financial aid officers and student loan companies designed to pick the pockets of students and their parents. As financial aid administrators know, the reality is much less nefarious." *Id.*

15. *See infra* Part III.A.

I. HISTORICAL LEGAL AND REGULATORY ENVIRONMENT

Congress enacted the Higher Education Act of 1965 "[t]o strengthen the educational resources of our colleges and universities and to provide financial assistance for students in postsecondary and higher education."[16] One of the major vehicles the government created through the HEA to meet this purpose was low-interest loan products for students, including the FFEL Program.[17] The FFEL Program consists of a federal program of student loan insurance for private lenders that eliminates the lender's risk of lending to students by insuring the principal balance of loans made under the HEA.[18] Under the program, private lenders make loans to students that are reinsured by the federal government indirectly through guaranty agencies.[19] The Department administers the program and exercises oversight over lenders and institutions, an essential part of which is to prevent conflicts of interest.[20] The effectiveness of the Department's administration of the program, however, is handicapped by a lack of clarity on prohibited activities and the absence of effective oversight and enforcement.

A. Ambiguity in the FFEL Program Framework

The failure to effectively police prohibited activities is fundamentally due to a lack of clarity caused by ambiguous definitions and guidance related to "prohibited inducements." As a starting point, the traditional HEA framework utilizes an "eligible lender" definition as a mechanism for proscribing certain behavior by disqualifying offenders from the program.[21] The relevant definition states as follows:

> The term "eligible lender" does not include any lender that the Secretary determines, after notice and opportunity for a hearing, has . . . offered, directly or indirectly, points, premiums, payments, or *other inducements*, to any educational institution or individual in order to secure applicants for loans under this part.[22]

The purpose of this definition was to disqualify lenders from the FFEL Program that attempted to secure loan volume by entering into quid-pro-quo arrangements with institutions or their employees.[23] In other words, Congress sought to ensure that financial aid offices served effectively as gatekeepers by eliminating the

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16. Higher Education Act of 1965, Pub. L. No. 89-329, 79 Stat. 1219 (codified as amended at 20 U.S.C. §§ 1001–1140 (2000 & Supp. 2005)).

17. 20 U.S.C. § 1071 (2000).

18. *See id.* § 1074(a).

19. *Id.* § 1078(a)–(c).

20. *See id.*; *see also* Coll. Loan Corp. v. SLM Corp., 396 F.3d 588, 590 (4th Cir. 2005).

21. 20 U.S.C. § 1085(d)(5).

22. *Id.* § 1085(d)(5)(A) (emphasis added).

23. *See* Blain B. Butner & Aaron D. Lacey, *Avoiding Illegal Lender Inducements*, STUDENT AID TRANSCRIPT, Mar. 1, 2006, at 32, *available at* http://www.nacua.org/documents/Lender Inducements2Blain.pdf.

potential for conflicts of interest.[24] The ambiguity of the phrase "other inducements," however, provided incomplete guidance to lenders and institutions on what exactly constituted a prohibited inducement.[25]

In subsequent years, Congress declined opportunities to define inducements with more clarity and "continually declined to clarify this sweeping law, despite the significant transformation of the FFEL industry since [its inception]."[26] The legislative history behind the HEA and its amendments similarly provides little insight.[27] Congress's most extensive effort to clarify the inducement provision came in a 1998 reauthorization amendment to HEA that provided an exception to the anti-inducement provision by outlining a range of acceptable activity.[28] In the amendment Congress added the following language:

> It shall not be a violation . . . for a lender to provide assistance to institutions of higher education comparable to the kinds of assistance provided to institutions of higher education by the Department of Education.[29]

The amendment, when read in conjunction with the Department's comments to its proposed 1999 regulations, established a "safe harbor" for certain activities, including counseling, outreach, computer support, and training.[30] Congress did not

24. *See* Federal Perkins Loan Program, Federal Family Education Loan Program, and William D. Ford Federal Direct Loan Program, 72 Fed. Reg. 61,960, 61,976 (Nov. 1, 2007) (to be codified at 34 C.F.R. pts. 674, 682, 685) (containing the Secretary's discussion of comments on the proposed regulations).

25. *See* 20 U.S.C. § 1085(d)(5) (2000 & Supp. 2005). The 1986 amendments to the HEA gave only cursory consideration to the issue by noting circumstances for "[d]isqualification [of lenders] for use of certain incentives." Higher Education Amendments of 1986, Pub. L. No. 99-498, § 435, 100 Stat. 1268 (1986) (codified as amended at 20 U.S.C. § 1085(d)(5) (2000 & Supp. 2005)).

26. Butner & Lacey, *supra* note 23, at 33.

27. *See* H.R. REP. NO. 99-383 (1985). The report states:

> Additionally, the Committee has become aware of practices that use incentives to attract new borrowers to certain lending institutions. The committee considers such activities to be contrary to the best interests of the program and feels that they represent exploitation of student and parent borrowers. Thus the Committee adopted language prohibiting such undertakings and disqualifying any lenders who continue these practices from participating in the Federal student loan programs.
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> However, it is not the intention of the Committee that lenders be prohibited from paying to an institution or a state guaranty agency reasonable fees for loan counseling, disclosure, or other administrative services that will promote the purposes of the Federal loan programs. Nor are these provisions intended to preclude lending institutions from sponsoring such activities as receptions and indirect support for organizations such as the National Council on Higher Education Loan Programs or the National Association of Student Financial Aid Administrators.

Id. at 37.

28. Higher Education Act Amendments of 1998, Pub. L. No. 105-244, 112 Stat. 1581 (codified as amended in scattered sections of 20 U.S.C. (2000 & Supp. 2005)).

29. Pub. L. No. 105-244 § 429, 112 Stat. 1708 (amending 20 U.S.C. § 1085(d)(5)).

30. *See* Federal Family Education Loan Program & William D. Ford Direct Loan Program, 64 Fed. Reg. 43,428, 43,429–30 (Aug. 10, 1999) (codified at 34 C.F.R. pts. 682, 685) (implementing changes made in the 1998 HEA amendments that create an exception to the

purport for the safe harbor to be an exhaustive list of acceptable activities, however, and the amendment did little to define "other inducements" with positive law.

Similarly, the Department only sporadically issued guidance aimed at clarifying the inducement provision of HEA.[31] A 1989 Dear Colleague Letter (DCL) from the Department contained its most detailed guidance, reminding lenders and institutions of their obligations under the HEA by stating that the provisions related to inducements "were broadly intended to prohibit the direct or indirect offering of payment of any kind of financial incentive to any entity or person to secure applicants for [FFEL] loans . . . regardless of the form of the incentive or its mode of payment."[32] The letter also listed various examples of prohibited activities, including the employment of any agents to solicit individual loans from students, the payment of referral or finder's fees, certain lender promotional activities, and the provision of printings, computer equipment, or services at a reduced or no cost.[33] Additionally, the letter references activities that "provide some financial benefit. . . but are nevertheless permissible because the financial value of the benefit is nominal, or the activity is not undertaken to directly secure applications from individual prospective borrowers."[34] While providing some refinement to the inducement provision, the guidance did not prevent a handful of lenders from offering inducements that the DCL did not directly proscribe.

Following the 1989 DCL, the Department did not issue further guidance on the subject of inducements until a subsequent 1995 DCL.[35] The 1995 DCL promised vigorous enforcement of the inducement provisions of the HEA and warned institutions to take the proper steps to allow borrowers to make decisions based on the merits of loan terms and conditions rather than marketing incentives.[36] The letter stated that the goal of the inducement provision was to "remov[e] an economic interest that may affect the school's objectivity as it advises the student with respect to financial assistance."[37] The guidance was ineffective, however, because it still did not satisfactorily distinguish between prohibited inducements and those incentives negotiated appropriately by institutions on behalf of

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prohibited inducement provision for certain counseling, outreach, computer support, and training activities); *see also* Butner & Lacey, *supra* note 23.

31. Aside from the few efforts already noted, the Department's primary guidance on the subject came in the form of a sporadic series of Dear Colleague Letters issued in 1989 and 1995. *See infra* notes 32, 35. The Department also issued guidance in connection with the creation of the Federal Direct Loan Program. *See* Federal Family Education Loan Program & William D. Ford Direct Loan Program, 64 Fed. Reg. at 43,428.

32. Letter from Dewey L. Newman, Deputy Assistant Sec'y for Student Fin. Servs., & Daniel R. Lau, Dir. of Student Fin. Assistant Programs, Dep't of Educ. (Feb. 27, 1989), *available at* http://www.nacua.org/documents/InducementsProhibited.pdf.

33. *Id.* The letter may have also confused the issue, however, by again defining prohibited inducements in the negative by vaguely describing activities permissible under federal law. *See id.*

34. *Id.*

35. Letter from Leo Kornfeld, Senior Advisor to Sec'y, Dep't of Educ. (Mar. 1, 1995), *available at* http://ifap.ed.gov/dpcletters/doc0134_bodyoftext.htm.

36. *Id.*

37. *Id.*

borrowers.[38]

As competition among FFEL lenders increased in the nineties with the introduction of the William D. Ford Federal Direct Loan Program,[39] some lenders utilized the continued ambiguity in the inducement provision to gain competitive advantage. By way of background, the Federal Direct Loan Program allows borrowers to bypass loans from private lenders through the FFEL Program and obtain funds for higher education directly from the government.[40] In passing the program, Congress expected that the arguably lower costs to both students and taxpayers would cause the program to grow quickly and surmount private-based, federally-backed programs such as the FFEL Program.[41] The direct loan program did grow quickly, but Congress underestimated the response from private lenders not willing to easily forego profitable and low risk FFEL Program lending.[42] In fighting back, some lenders exploited the vacuum created by the government's failure to set forth any clear standard for prohibited inducements by offering incentives to institutions aimed at increasing loan volume.[43]

Such activities did not go unnoticed by the Department. The Department's Office of Inspector General (OIG) reported on the issue as early as August 2003, when it released an Alert Memorandum reviewing alleged lender inducements.[44] Prompted by an allegation that a lender offered illegal inducements to institutions in exchange for increased loan volume, the OIG conducted a review that identified several shortcomings in the Department's guidance on illegal inducements.[45] Specifically, the OIG noted that the Department had not issued guidance since 1995 and that its informal guidance was insufficient.[46] Based on its review, the OIG determined that certain improper bargaining practices existed between lenders and institutions in violation of the anti-inducement provisions.[47] As a result, the OIG's Memorandum suggested several changes to the Department's practices that would recognize the "current market realities in the FFELP," including guidance on the application of the anti-inducement provision and consideration of statutory

38. *See id.*

39. Improving America's Schools Act of 1994, Pub. L. No. 103-382, § 355(a), 108 Stat. 3967 (codified at 20 U.S.C. § 1078(c)(1)(G) (2000 & Supp. 2005)).

40. 20 U.S.C. § 1078.

41. Glater & Arenson, *supra* note 5.

42. *Id.*

43. *Id.* These means include inducing institutions to leave the federal direct loan program, to obtain preferred lender status, and to enter arrangements under the college-as-lender program. *See infra* Part III.A; *see also* Barnett et al., *supra* note 11.

44. Memorandum from Cathy H. Lewis, Assistant Inspector Gen., Educ., Inspection, and Mgmt. Servs. to Sally Stroup, Assistant Sec'y, Office of Postsecondary Educ. (Aug. 1, 2008) (on file with author), *available at* http://www.nacua.org/documents/AlertMemo_LenderInducements.pdf.

45. *Id.*

46. *Id.*

47. *Id.* Specifically, the review concluded that at least one of two schools investigated had negotiated with Sallie Mae for preferred lender status in exchange for private loans to the institution. *Id.*

and regulatory changes.[48]

In an attempt to prevent government intervention, a consortium of private organizations issued a "set of guidelines . . . concerning compliance with certain inducement prohibitions" in the HEA.[49] The consortium promised to encourage lender and institutional compliance with the "letter and spirit of the guidelines."[50] It intended for the guidelines to supplement existing guidance and recommended against certain arrangements between lenders and institutions, including exchanging private loans for FFEL Program loan volume, offering referral or marketing fees, and offering excessive gifts or entertainment.[51] Ultimately, the foregoing government and private efforts at providing guidance were inadequate in providing sufficient clarity to the inducement provision of the HEA.

B. Oversight and Enforcement of FFEL Programs

In addition to ambiguity in the FFEL framework, the administration of the Program suffered from ineffective oversight and meager enforcement.[52] An OIG Audit found that the General Manager of Financial Partners (Financial Partners), the federal entity that administers the FFEL Program, established a "weak control environment for monitoring and oversight."[53] The report attributed this weakness in large part to a fundamental problem with Financial Partners' approach in administering the program. The report maintained that Financial Partners emphasized partnership with program participants rather than an atmosphere of compliance.[54] This view is substantiated by Financial Partners' own mission statement, which outlines its mission as follows:

> [T]o promote the best in business and strive for greater program integrity through innovative technical development, oversight, technical assistance, partnership and community outreach programs by working in partnership with Guaranty Agencies, Lenders, Servicers, Trade Associations, Trustees, Schools and Secondary Markets to ensure

48. *Id.*

49. Press Release, Consumer Bankers Ass'n., Educ. Fin. Council, & Nat'l Council of Higher Educ. Loan Programs, Inc., Loan Associations Endorse Inducement Guidelines (Nov. 16, 2004), *available at* http://www.nchelp.org/news/inducementguidelines11-16-04.pdf.

50. *Id.*

51. *Id.*

52. *See* OFFICE OF INSPECTOR GEN., U.S. DEPT. OF EDUC., REVIEW OF FINANCIAL PARTNERS' MONITORING AND OVERSIGHT OF GUARANTY AGENCIES, LENDERS, AND SERVICERS, FINAL AUDIT REPORT 6 (2006), *available at* http://www.ed.gov/about/offices/list/oig/auditreports/a04e0009.pdf. Terry W. Hartle, Senior Vice President at the American Council on Education, succinctly described the situation as "[w]hat [happens when] unbridled competition meets lack of oversight." Glater & Arenson, *supra* note 5.

53. OFFICE OF INSPECTOR GEN., *supra* note 52, at 2. The responsibility for administering the FFEL program is given to the General Manager of Financial Partners (Financial Partners), a division of Federal Student Aid. At the time of the audit report, Financial Partners had seventy-five employees scattered across several regional offices and duty stations. With this minimal staff, Financial Partners administered oversight on approximately 3400 lenders, 35 guaranty agencies, 72 third-party servicers, and other program participants. *Id.* at 4.

54. *Id.* at 8.

access for students to federal student loans.[55]

This partnership-oriented approach created a conflict of interest and led to insufficient monitoring of program participants.[56]

As a result, the agency did not "adequately review, test, identify, and report significant instances of non-compliance in its program reviews and technical assistance."[57] Fundamentally, the Report found that the policies and procedures in place for lender oversight were inadequate and lacking in supervision.[58] Even those policies and procedures that were in place for conducting reviews of program participants were not followed.[59] The ultimate result was that Financial Partners poorly implemented procedures utilized for oversight.[60] The agency severely under-utilized the risk assessment tool it used to identify problem areas and ensure compliance with the FFEL Program.[61] As a result, Financial Partners did not focus its limited resources on the program partners who were most at risk.[62]

The Department's lack of administrative oversight predictably led to a serious failure to administratively or judicially enforce the inducement provision. In *LTV Education Systems, Inc. v. Bell*, one of the Department's few judicial proceedings on the inducement issue, the court observed that the Department's action against LTV for violating the "points and premiums" provision of Department regulations was the "government's first reported judicial enforcement of the points and premiums regulation, a regulation promulgated [eighteen] years ago."[63] The court called the Department's enforcement policy "schizophrenic" and noted a "less than

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55. *Id.* at 7–8.

56. *See id.* at 8. The public-private partnership is not per se a weakness of the FFEL Program; rather, it is a weakness insofar as it leads to insufficient oversight. See *infra* Conclusion, for a brief discussion of the value of public-private partnership.

57. *See id.*

58. *Id.*

59. *Id.*

60. *Id.*

61. *Id.* Specifically, Financial Partners never fully implemented the risk assessment tool, failed to complete written policies and procedures for carrying it out, and neglected to put a process in place to determine the effectiveness of the risk assessment model. *Id.*

62. *See id.*

63. LTV Educ. Sys., Inc. v. Bell, 862 F.2d 1168, 1174 (5th Cir. 1989). The "points and premiums" regulation promulgated under the HEA was a predecessor to the inducement provision added at 20 U.S.C. § 1085(d)(5)(A) and read as follows:

> No points, premiums or additional interest of any kind may be paid to any eligible lender in order to secure funds for making loans or to induce such a lender to make loans to the students of a particular institution or any particular category of students and, except in circumstances approved by the Commissioner, notes (or any interest in notes) evidencing loans made by educational institutions shall not be sold or otherwise transferred at a discount.

45 C.F.R. § 177.6(e)(1) (1970). In the LTV case, an operator of private trade schools brought suit against the Department, maintaining breach of insurance contract after the Department ceased making payments on defaulted federal loans. *LTV*, 862 F.2d at 1171. The Department moved for summary judgment on the grounds that LTV was disqualified from the program for maintaining compensating balances with lenders in violation of the points and premiums regulation. *Id.* at 1171–72. The court affirmed the district court's grant of the Department's motion for summary judgment. *Id.* at 1177.

admirable shift in [the Department's] enforcement policy."[64]

In addition, the OIG noted that, as of 2003, the Department had brought only one formal administrative action on the prohibited inducement provision added to HEA in 1986.[65] Its lone effort proved futile as a district court held that the Department's limitation of Student Loan Marketing Association's participation in the FFEL Program was arbitrary and capricious.[66] These minimal efforts characterize the Department's lax approach to enforcing the anti-inducement provisions of the HEA.

The foregoing shortcomings permitted some lenders to operate with impunity in the gray areas of the anti-inducement provision. The lack of guidance as to what exactly constituted a prohibited inducement combined with an extreme lack of oversight and enforcement left a vacuum that lenders exploited in some instances. As increased borrowing and the introduction of the Federal Direct Loan Program increased competition in the industry, the conflict of interest problem caused by these inducements became much more visible, ultimately prompting reform.

II. ORIGINS OF REFORM EFFORTS

Although inquiries into student lending practices resulted in extensive reforms at the federal level, the genesis of these reforms can be traced back to state investigations. New York Attorney General Eliot Spitzer led the earliest and most publicized investigation, which his successor Andrew Cuomo continued and expanded.[67] During the course of the investigation, the New York Attorney General's office uncovered instances of conduct that it viewed as improper lender inducements.[68] The practices involved allegedly improper arrangements between institutions and lenders whereby the former were given inappropriate inducements in exchange for providing loan volume to the lenders.[69] Chief among these practices were "kickbacks" from lenders to institutions in exchange for loan

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64. *Id.* at 1175.

65. Memorandum from Cathy H. Lewis, *supra* note 44.

66. Student Loan Mktg. Ass'n v. Riley, 112 F. Supp. 2d 38 (D.D.C. 2000). In that case, Student Loan Marketing Association (SLM) appealed the Department's administrative determination that it violated the prohibited inducement provision of HEA by repurchasing loans at a premium made under the school-as-a-lender program. *Id.* at 39. The court held that the Department's determination was "arbitrary and capricious" and set it aside under 5 U.S.C. § 706(2)(A) (2000) because SLM's activities were not aimed at securing additional loan applications and SLM could not be characterized properly as a lender when it was in fact a third-party service provider under the arrangement. *See id.* at 43.

67. AM. COUNCIL ON EDUC., BACKGROUND INFORMATION FOR PRESIDENTS AND CHANCELLORS ON THE RECENT CONTROVERSY SURROUNDING STUDENT LOANS (Apr. 16, 2007), *available at* http://www.acenet.edu/AM/Template.cfm?Section=Legal_Issues_and_Policy_Briefs2&CONTENTID=21777&TEMPLATE=/CM/ContentDisplay.cfm.

68. Press Release, Andrew M. Cuomo, N.Y. State Att'y Gen., Office of the N.Y. State Att'y Gen., Attorney General Expands College Loan Investigation to Direct Marketing Companies (Oct. 11, 2007), *available at* http://www.oag.state.ny.us/press/2007/oct/oct11a_07.html. Cuomo claimed to uncover "deceptive practices" adverse to the interests of students resulting from what he called an "unholy alliance" between institutions and lenders. *Id.*

69. *Id.*

volume, extra benefits provided to curry favor with institutions, lender payments to institutions to encourage them to drop out of the Federal Direct Loan Program, and improper gifts or services provided by lenders to institutions in exchange for placement on preferred lender lists.[70] This investigation eventually resulted in the State's passage of the Student Lending Accountability, Transparency and Enforcement Act,[71] which codified a Student Bill of Rights, and several financial settlements with lenders.[72]

Fearing that similar investigations would lead to disparate state regulations and hamper monitoring efforts, Congress and the Department acted hastily to tighten federal oversight of student lending.[73] In December 2006, shortly after Spitzer announced the New York investigation, the Department began a negotiated rulemaking process to amend federal student loan program regulations.[74] The goal of the rulemaking process, which targeted, inter alia, prohibited inducements and preferred lender lists, was to develop new regulations suitable to all constituencies affected by the rules.[75] To start the process, the Department drafted a set of amendments to the current regulations and solicited commentary from lenders, institutions, and private organizations.[76] The Department published the final regulations in November 2007, and most of these regulations will become effective in July 2008.[77]

For its part, Congress hurriedly introduced several pieces of legislation aimed at inducements, which ultimately resulted in bills to amend the HEA.[78] The House of Representatives ("House") version of the bill is most comprehensive, containing a series of integrity provisions intended to prohibit specific inducement activities, guidelines for preferred lender lists, and new enforcement mechanisms.[79] The Senate version, while not as comprehensive, addresses "educational loan arrangements" and revises the definition of eligible lender to include more specificity on prohibited inducements.[80] Together, the foregoing regulatory and legislative reform measures address many perceived areas of weakness in the

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70. *Id.*

71. N.Y. EDUC. LAW §§ 620–632 (McKinney 2007).

72. Press Release, Andrew M. Cuomo, *supra* note 68.

73. John W. Schoen, *Will Student Loan Reforms Cut Borrowers' Costs?*, MSNBC, Aug. 29, 2007, http://www.msnbc.msn.com/id/20397254/.

74. AM. COUNCIL ON EDUC., *supra* note 67.

75. *Id.*

76. *Id.*

77. Federal Perkins Loan Program, Federal Family Education Loan Program, and William D. Ford Federal Direct Loan Program, 72 Fed. Reg. 61,960 (Nov. 1, 2007) (to be codified at 34 C.F.R. pts. 674, 682, 685).

78. The House of Representatives and Senate introduced several different pieces of legislation aimed at conflicts of interest in the FFEL Program. *See, e.g.*, Student Loan Sunshine Act, H.R. 890, 110th Cong. (2007); Student Loan Sunshine Act, S. 486, 110th Cong. (2007); Student Loan Accountability and Disclosure Reform Act, S. 1262, 110th Cong. (2007). Most of these bills are now incorporated into House and Senate versions of HEA amendments. *See infra* notes 79–80 .

79. *See* College Opportunity and Affordability Act of 2007, H.R. 4137, 110th Cong. §§ 151–153, 155–156 (2007).

80. Higher Education Amendments of 2007, S. 1642, 110th Cong. §§ 151–153, 428 (2007).

existing HEA framework.

III. IMPORTANT AREAS OF REFORM

Federal reforms of the FFEL Program target two principal conflict of interest problems. First, the Department and Congress addressed prohibited inducements in order to ensure the integrity of the FFEL Program and keep borrowing costs as low as possible. Second, the reforms addressed preferred lender lists to ensure that institutions use appropriate selection criteria when developing such lists. Importantly, reforms also add more meaningful enforcement mechanisms to address the oversight and enforcement shortcomings prevalent in the Program. These three important areas of reform will be discussed in turn.

A. Prohibited Inducements

The regulatory and statutory reforms related to the inducement provision of the HEA establish the boundaries of acceptable activity for lenders and institutions with increased clarity. The House and Senate versions of the HEA Amendments would address inducements in different manners. The House version, as previously mentioned, would establish a series of comprehensive integrity provisions to prohibit a broad range of activities that lead to conflicts of interest.[81] The Senate version is slightly less ambitious and would largely address the inducement provision by expanding the "eligible lender" definition to provide increased clarity.[82] The Department's regulations fall somewhere in between, incorporating a modified version of previous guidance to supplement the amorphous inducement provision.[83] Together, these reforms target specific types of conduct that create apparent conflicts of interest contrary to the interests of borrowers.

First, the reforms target lender provision of gifts and services to colleges and universities in exchange for increased loan volume or other preferential treatment. A Senate investigation of such practices concluded that five lenders made large marketing expenditures directed towards certain schools or events that could be viewed as improper incentives.[84] These purchases included tickets for sporting events, premiums and promotional items, meals for college and university employees, luncheons and receptions for students, and sponsorships and "direct access" marketing.[85] Lenders also made periodic expenditures for "value-added

81. *See* H.R. 4137.

82. S. 1642, § 428; *see also* 20 U.S.C. § 1085(d)(5)(A) (2000 & Supp. 2005) (containing the current definition for "eligible lender").

83. *See* Federal Perkins Loan Program, Federal Family Education Loan Program, and William D. Ford Federal Direct Loan Program, 72 Fed. Reg. 32,410, 32,420 (proposed June 12, 2007) (to be codified at 34 C.F.R. pts. 674, 682, 685).

84. HEALTH, EDUCATION, LABOR, & PENSIONS COMMITTEE, 110TH CONG., REPORT ON MARKETING PRACTICES IN THE FEDERAL FAMILY EDUCATION LOAN PROGRAM 12 (Comm. Print 2007), *available at* http://kennedy.senate.gov/imo/media/doc/Student%20Loan%20Report.pdf.

85. *Id.* at 15–17.

services" such as banking, printing, and counseling services.[86] The Senate investigation concluded that marketing expenditures were "out of control," creating an appearance of conflict even where the then-existing FFEL regime did not specifically prohibit many of these activities.[87]

The regulations target such activities by prohibiting lenders from providing gifts and other benefits to institutions or employees of those institutions.[88] The only gifts permitted under the regulations are "items of nominal value that constitute a form of generalized marketing or are intended to create good will."[89] The House version of the HEA amendments would establish a prohibition on gifts, preventing any financial aid office employee from soliciting or accepting any gifts from a lender.[90] The Senate version would not specifically establish a gift ban, but it would add prizes, entertainment expenses, and the provision of information-technology equipment at a reduced cost to the list of prohibited activities under the definition of eligible lender.[91] The reforms suggest that the Department will consider most gifts prohibited inducements.

Second, the reforms target lender-established advisory boards. Lenders purportedly formed such boards to receive feedback from college and university officials in order to improve products and services for institutions and borrowers.[92] Critics argue, however, that some lenders used the boards to circumvent the inducement guidelines and build inappropriate relationships with college and university officials.[93] A Senate investigation found that, even where specific quid pro quo arrangements did not exist, lenders at times used the advisory boards "to curry favor with school officials and provide lavish perquisites to those officials," creating a high risk of prohibited inducements.[94] For example, one lender struggling to obtain market share offered a complimentary trip to college and university officials and their spouses to a Four Seasons Resort in the Carribean to

86. *See id.* at 19–23.

87. *Id.* at 14; *see also id.* at 19 (noting that certain of the activities mentioned "[did] not fall within any exception to the inducement provision").

88. *See* Federal Perkins Loan Program, Federal Family Education Loan Program, and William D. Ford Federal Direct Loan Program, 72 Fed. Reg. at 32,420.

89. *Id.* at 32,421

90. College Opportunity and Affordability Act of 2007, H.R. 4137, 110th Cong. § 155 (2007). The legislation defines a gift as "any gratuity, favor, discount, entertainment, hospitality, loan, or other item having monetary value of more than a de minimum amount." *Id.* Certain exceptions exist to this ban, including (1) food, refreshments, and training as an integral part of a training session designed to improve the service of a lender, (2) exit counseling services, and (3) philanthropic contributions that are unrelated to education loans. *Id.*

91. Higher Education Amendments of 2007, S. 1642, 110th Cong. § 428 (2007).

92. *See* Jonathan D. Glater, *Offering Perks, Lenders Court Colleges' Favor*, N.Y. TIMES, Oct. 24, 2006, at A1 (quoting multiple college and university officials stating that the advisory board meetings are a "mechanism for giving feedback" and cover topics "that would be benefits for all students").

93. *See* REPORT ON MARKETING PRACTICES IN THE FEDERAL FAMILY EDUCATION LOAN PROGRAM, *supra* note 84, at 24; *see also* Glater & Arenson, *supra* note 5.

94. *See* REPORT ON MARKETING PRACTICES IN THE FEDERAL FAMILY EDUCATION LOAN PROGRAM, *supra* note 84, at 26.

participate in a summit.[95] Another advisory board meeting destination was a trip to a Pebble Beach resort in which a lender paid all travel and lodging expenses for college and university officials who attended.[96] While such events can be valuable information sharing opportunities, critics argue that they are nothing more than junkets that lead to improper relationships between lenders and institutions at the expense of borrowers.[97]

The various federal reform measures take differing positions on advisory board participation by college and university officials. The Senate's legislation would not prohibit advisory boards but would forbid compensation to college and university officials for serving on the boards except for reimbursement of reasonable travel expenses.[98] The House integrity provisions would go farther, prohibiting officials from participating in lender advisory councils altogether.[99] The Department's revised regulations, however, only indirectly address the issue of advisory board participation. While they do not specifically prohibit such participation, the regulations prevent lenders from paying most of the associated costs. For instance, lenders are prohibited from paying "any lodging, rental, transportation, and other gratuities related to lender-sponsored activities for employees of a school or a school-affiliated organization."[100] With varying levels of strictness, the federal reforms suggest that lenders and college and university officials avoid conferences that give an appearance of impropriety.

Third, reforms address situations in which college and university officials hold financial interests of various kinds in lenders.[101] These reforms generally address two different areas that might result in conflicts: college and university officials holding stock in or receiving consulting contracts from lending companies. Such arrangements were isolated and rare, with only a few instances of note, but typically led to the lender's appearance on the preferred lender lists at those particular institutions.[102] For instance, financial aid directors at three institutions held stock in one lender.[103] In one of those situations in particular, the lender appeared at the top of the school's preferred lender list while its financial aid director owned shares in the company that the official eventually sold for a

95. *See* Glater, *supra* note 92.

96. Cuomo, *supra* note 68.

97. *See* Glater & Arenson, *supra* note 5.

98. Higher Education Amendments of 2007, S. 1642, 110th Cong. § 428 (2007).

99. College Opportunity and Affordability Act of 2007, H.R. 4137, 110th Cong. § 155 (2007).

100. Federal Family Education Loan, 72 Fed. Reg. 61,960, 61,999 (Nov. 1, 2007) (to be codified at 34 C.F.R. § 682.200).

101. Stephen Burd, *Borrowing Trouble*, L.A. TIMES, Apr. 10, 2007, at A19.

102. *See* REPORT ON MARKETING PRACTICES IN THE FEDERAL FAMILY EDUCATION LOAN PROGRAM, *supra* note 84, at 3, 33–40; *see also* Jonathan D. Glater & Sam Dillon, *Student Lender Had Early Plans to Woo Officials*, N.Y. TIMES, Apr. 10, 2007, at A1.

103. Glater & Dillon, *supra* note 102. The article also points out that a Department official owned stock in the company as well. *Id.* It is also asserted that "[a]t least eight top officials in the Education Department . . . either came from student-loan or related organizations or have taken lucrative jobs in that arena since leaving the agency." John Hechinger & Anne M. Chaker, *Did Revolving Door Lead to Student Loan Mess?*, WALL ST. J., Apr. 13, 2007, at B1.

substantial profit.[104]

Similarly, in a few instances college and university officials received large consulting contracts and other payments from lenders that were on their preferred lender lists or otherwise recommended to students.[105] In the most excessive example, a school official received over $93,000 in consulting fees from a particular lender over a period of several years.[106] That lender consistently appeared on the institution's preferred lender list.[107] In fact, its share of loan volume at the institution increased from thirty-four percent in 2002 to nearly forty-four percent in 2006.[108] While the school official frequently sent invoices to the lender for services rendered, there was no formal consulting contract between the two and no evidence that the official performed any specific consulting services for the lender.[109]

Reform measures address both of these situations with differing approaches. The House integrity provisions directly prohibit any type of contracting arrangement between lenders and college and university officials.[110] This includes a prohibition on "any fee, payment, or other financial benefit (including the opportunity to purchase stock) as compensation for any type of consulting arrangement or other contract to provide services to the lender."[111] The Senate bill and Department regulations take a somewhat more amorphous approach. The Senate bill would expand the inducement definition to prohibit lenders from offering payments, stocks, and tuition repayment in exchange for loan volume.[112] Implementing regulations initially do not address the issue directly.[113] The conflicting approaches fail to establish a reliable standard at this point, but a safe assumption is that the Department will view any stock or consulting arrangements as a conflict of interest because of the vested interest it gives college and university officials in a particular lender.

Finally, reforms target certain financial arrangements between lenders and institutions. The most common examples of such arrangements include opportunity pools and revenue-sharing arrangements.[114] Opportunity pools are funds advanced from the lender to the institution to loan to students "with little or no underwriting criteria."[115] Institutions use these funds to help students close the

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104. *See* REPORT ON MARKETING PRACTICES IN THE FEDERAL FAMILY EDUCATION LOAN PROGRAM, *supra* note 84, at 24–26.

105. Glater & Dillon, *supra* note 102.

106. *See* REPORT ON MARKETING PRACTICES IN THE FEDERAL FAMILY EDUCATION LOAN PROGRAM, *supra* note 84, at 41.

107. *Id.*

108. *Id.*

109. *Id.*

110. College Opportunity and Affordability Act of 2007, H.R. 4137, 110th Cong. § 155 (2007).

111. *Id.*

112. Higher Education Amendments of 2007, S. 1642, 110th Cong. § 428 (2007).

113. *See* Federal Family Education Loan, 72 Fed. Reg. 61,960, 61,978 (Nov. 1, 2007) (to be codified at 34 C.F.R. pt. 682.200).

114. *See* Barnett et al., *supra* note 11.

115. HEALTH, EDUC., LABOR, & PENSIONS COMM., 110TH CONG., SECOND REPORT ON

gap between tuition and federal loan caps, which assists institutions in providing the dual benefit of supplying need-based aid to prospective students and keeping enrollment rates high.[116]

Revenue-sharing arrangements existed in many different forms, but in the private lending context they were based primarily on a model utilized by institutions participating in the federal "School as Lender" program.[117] Under the "School as Lender" program, institutions that meet certain threshold qualifications can serve as lenders under the FFEL Program and loan funds to graduate students.[118] Institutions participating in this program typically use the profits from the lending operation to provide scholarships and need-based grants to students.[119] Lenders and institutions replicated this model, seemingly legitimized in *Student Loan Marketing Association v. Riley*,[120] in the private lending context by entering into revenue sharing arrangements in which institutions received compensation based upon loan volume.[121] For instance, institutions may receive a percentage of the interest earned on loans referred to certain lenders.[122] Critics maintain that this money could instead be used to reduce borrowing costs for students and parents.[123]

Federal reform measures address financial arrangements between lenders and institutions in a direct and comprehensive manner. The House integrity provisions would establish an outright ban on revenue sharing arrangements.[124] Additionally, the legislation would prohibit lenders from offering funds to institutions that may be used to extend private loans to students, including opportunity pool arrangements.[125] The Senate version does not prohibit such arrangements but instead establishes a comprehensive scheme for disclosing the nature of such

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MARKETING PRACTICES IN THE FEDERAL FAMILY EDUCATION LOAN PROGRAM 7 (Comm. Print 2007), *available at* http://kennedy.senate.gov/imo/media/doc/second_report%20final.pdf; *see also* Press Release, Andrew M. Cuomo, *supra* note 68. For instance, one lender offered a total of $7 million in opportunity pool funds to two large, public universities in exchange for their withdrawal from the federal direct loan program. Glater & Arenson, *supra* note 5.

116. *See* Barnett et al., *supra* note 11.

117. *See* Higher Education Act of 1965, Pub. L. No. 89-329, 79 Stat. 1219 (codified as amended in scattered sections of 20 U.S.C. (2000 & Supp. 2005)).

118. 20 U.S.C. § 1085(2)(F) (2000 & Supp. 2005).

119. Loyola University Chicago, School as Lender Program: FAQS, http://www.luc.edu/finaid/sal_faq.shtml (last visited Apr. 11, 2008).

120. 112 F. Supp. 2d 38 (D.D.C. 2000). See *supra* note 66, for a full discussion of the case.

121. In one such arrangement, a revenue sharing agreement between a lender and an institution paid the institution half a percent of the interest earned on loans referred to the lender. The institution made over $100,000 through the agreement, which resulted in the lender obtaining ninety eight percent of the school's student loan volume. Armen Keteyian et al., *Target of Investigation*, CBS NEWS, Mar. 16, 2007, http://www.cbsnews.com/stories/2007/03/16/eveningnews/main2579808.shtml.

122. *Id.*

123. *Id.*

124. College Opportunity and Affordability Act of 2007, H.R. 4137, 110th Cong. § 155 (2007). The legislation defines a "revenue sharing arrangement" as a situation in which "the institution recommends the lender" and, "in exchange, the lender pays a fee or provides other material benefits, including revenue or profit sharing, to the institution." *Id.*

125. *Id.*

"educational loan arrangements" to borrowers, the Department, and Congress.[126]

More specifically, before providing a student loan, the lender must disclose certain specific information about the loan to the borrower, including interest rates, fees, repayment plans, term and conditions of forbearance, and collection practices.[127] Institutions would also have an obligation under this regime to submit an annual report to the Department for each arrangement. The report must detail the information mentioned above along with "a detailed explanation of why the covered institution believes the terms and conditions of each type of educational loan provided pursuant to the agreement are beneficial for students attending the covered institution."[128] The Senate version would take a less favorable approach to this revenue model in the "School as Lender" context, sunsetting the program and forbidding schools from participating in FFEL as lenders.[129] The Department's regulations take an approach mirroring that proposed by the House by banning any payments for loan applications or referrals.[130] At a minimum, these various reform proposals will require disclosure of financial arrangements between lenders and institutions that give the appearance of conflict in order to allow students and parents to make more informed borrowing decisions.

Aside from detailing specifically prohibited activity, the regulations also provide an exhaustive list of permissible activities. The Department provided these safe harbor provisions to allow lenders to compete on a level playing field against the federal government by providing assistance comparable to that allowed under the direct loan program.[131] More specifically, lenders may offer reduced origination fees or reduced interest rates, pay off federal default fees on behalf of the borrower, and purchase loans from other loan holders at a premium.[132] The proposed regulations would also specifically enable lenders to engage in the following activities:

1. Participate in student financial aid outreach activities so long as the lender does not market its products or services and the lender provides full disclosure of

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126. Higher Education Amendments of 2007, S. 1642, 110th Cong. § 151(4) (2007).

> The term `educational loan arrangement' means an arrangement or agreement between a lender and a covered institution—(A) under which arrangement or agreement a lender provides or otherwise issues educational loans to the students attending the covered institution or the parents of such students; and (B) which arrangement or agreement--(i) relates to the covered institution recommending, promoting, endorsing, or using educational loans of the lender; and (ii) involves the payment of any fee or provision of other material benefit by the lender to the institution or to groups of students who attend the institution.

Id.

127. *Id.* § 152.

128. *Id.* § 153.

129. *Id.* § 428. Under the amendment, the program would expire on June 30, 2012. *Id.* § 428(A).

130. *See* Federal Perkins Loan Program, Federal Family Education Loan Program, and William D. Ford Federal Direct Loan Program, 72 Fed. Reg. 32,410, 32,421 (proposed June 12, 2007) (to be codified at C.F.R. pt. 682.200).

131. *Id.* at 32,420. The reality might be just the opposite, i.e., that the federal reforms will allow the Federal Direct Loan Program to compete with private lenders. *Id.*

132. *Id.*

any sponsorship;

2. Establish communication systems for the FFEL program, including a toll free telephone number and free data transmission services;

3. Offer repayment incentive programs to borrowers, including reduced interest rates and forgiveness of loan principal;

4. Sponsor meals, refreshments, and receptions to school officials and employees provided they are reasonable in cost and in conjunction with meeting and conference events; and

5. Provide institutions and borrowers items of nominal value through generalized marketing campaigns or to create good will.[133]

Together with the detailed prohibitions on certain activities, these safe harbors provide a substantially clearer picture on the acceptable range of activities for lenders and institutions.

While these reforms address important gray areas in the inducement provision, they are poorly conceived and create numerous unintended consequences. In large measure, these shortcomings are due to the draconian nature of the government investigations and reforms, which intimidated financial aid professionals and led to a media frenzy.[134] Rather than carefully considering the scope of the problem and drafting thoughtful, targeted reforms, Congress and the Department ushered through overbroad reforms that in many instances counter the HEA's objective of providing maximum borrower benefits and accessibility to students.[135] For instance, the reforms create greater legal uncertainty, increase borrowing costs and impede access to funds, and reduce the quality of customer service.

Fundamentally, the reforms create a broader, even if temporary, legal uncertainty for lenders and institutions seeking compliance with the rules. As the foregoing discussion illustrates, the various reforms arrive at substantially different solutions to many issues. This may be due to the reactionary approach to federal reforms, in which the Department issued implementing regulations before Congress amended the overarching statute.[136] Adding various reforms at the state level to the mix further complicates the issue for lenders and institutions. In other words, while the inducement standards have more clarity, several standards exist, at least temporarily, which complicate compliance efforts.[137]

Additionally, the reforms in some areas suffer from the unintended consequence

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133. *Id.*

134. Donald E. Heller, *Student Loans, the Baby and the Bathwater*, INSIDE HIGHER ED., Apr. 17, 2007, http://www.insidehighered.com/views/2007/04/17/heller. Mr. Heller notes that recent government action has many financial aid professionals "living in fear" and "on the defensive." *Id.*

135. *See infra* notes 141–151 and accompanying text.

136. While some respondents argued that the regulations were premature as a result, the Department maintained that the situation required expedited reform in advance of Congressional action. Federal Family Education Loan, 72 Fed. Reg. 61,960, 61,977 (Nov. 1, 2007) (to be codified at 34 C.F.R. pt. 682.200).

137. Note that the House and Senate versions of the HEA Reauthorization Amendments will eventually be reconciled, but the reconciled bill may still conflict with some provisions of the final regulations promulgated by the Department. See *infra* note 195, for a discussion of the reconciliation of the House and Senate Bills.

of unnecessarily restricting several activities that may ultimately benefit borrowers. For instance, many of the reforms restrict advisory board participation by financial aid office employees. Feedback from financial aid employees in advisory capacities, however, has the potential to "contribute to greater responsiveness and effectiveness of the student loan industry."[138] Such dialogue ultimately will benefit borrowers by leading to lower costs and improved products and services.[139] While restrictions on excessive compensation may be appropriate in this context, other prohibitions contained in some reforms on reasonable compensation for travel, meals, and other expenses related to serving on advisory boards unnecessarily complicate dialogue that can benefit students.[140]

Similarly, the reforms have the potential to effectively increase the cost of borrowing for students and parents and reduce access for low-income students. For instance, prohibitions on opportunity pools and revenue sharing arrangements eliminate lending sources and revenue streams that institutions previously utilized to provide loans and scholarships to students.[141] Many institutions also use these funds to offset stagnation in funding of need-based financial aid.[142] The elimination of revenue sharing agreements or "School as Lender" arrangements will cut off a vital source of funding and decrease access to higher education.[143] Mandating disclosure is a sensible measure, but the complete elimination of this model reduces competition and borrower benefit and is counter to the HEA objective of increasing access to higher education.

Additionally, excessive restrictions on lenders and an overt government effort to promote the direct loan program ultimately resulted in a "profit squeeze" on lenders.[144] Such intervention resulted in cutbacks on loan incentives and a reduction in borrower benefits.[145] Also, the excessive restrictions will contribute to greater instability in the student loan industry as the resulting shakeout will lead some lenders to cease operation.[146] Collectively, these industry pressures will reduce competition that leads to greater borrower benefits, create greater instability, and limit borrower choice.[147] While reform efforts are commendable

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138. Letter from Constantine W. Curris, President, Am. Ass'n of State Colls. and Univs., to Margaret Spellings, Sec'y, Dep't of Educ. (June 7, 2006) (on file with author), *available at* http://www.aascu.org/leadership/curris_060707.htm

139. *See* Heller, *supra* note 134.

140. *See id.*; *see also* Glater, *supra* note 92.

141. Chitty, *supra* note 7.

142. *Id.*

143. *See* Loyola University Chicago, School as Lender Program: FAQS, http://www.luc.edu/finaid/sal_faq.shtml (last visited Apr. 11, 2008).

144. Schoen, *supra* note 73.

145. *Id.*

146. *Id.*

147. *See* Press Release, Sallie Mae, Financial Aid Officials: Cuts to Private Sector Student Lending Program Will Increase Cost of Attendance and Reduce Services (Feb. 8, 2007), *available at* http://www.salliemae.com/about/news_info/newsreleases/020807_faas+on+FFELP.htm (containing a sample of comments from thirteen financial aid officials and a summary stating that "[f]inancial aid administrators and school officials expressed concern that the proposed cuts will significantly increase the cost of college for students and families, greatly

insofar as they increase transparency and seek to eliminate conflicts in the FFEL Program, an uncertain legal standard and excessive restrictions on lenders negate the otherwise positive aspects of the reform measures.

B. Preferred Lender Lists

The issue of prohibited inducements is one that is very closely related to preferred lender lists. Preferred lender lists are lists of recommended lenders developed by financial aid offices based upon certain selection criteria.[148] Institutions develop these lists "to help families sort through the ever growing array of available loan terms and conditions and to identify loans with the most favorable borrower benefits."[149] Properly constructed preferred lender lists are a valuable resource for borrowers because they create greater efficiencies in determining the most favorable loan terms.[150] The lists may also benefit borrowers indirectly by resulting in administrative cost-savings to institutions that can be passed on to borrowers.[151] When institutions use improper selection criteria such as inducements to develop the lists, however, this potentially valuable resource can mislead borrowers into selecting loans based on considerations other than merit.

From a lender's perspective, preferred lender lists represent a promising way to increase loan volume.[152] Placement on such a list typically provides substantial returns for a lender in terms of loan volume. According to the New York Attorney General's investigation, lenders on preferred lender lists "typically receive in aggregate up to 90% of the loans taken out by the institution's students and their parents."[153] While this concentration of borrowing often reflects a particular lender's superior product and service offerings, in some instances something more

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diminish services, and will dramatically reduce competition by squeezing many student loan providers out of the market.").

148. *See* Chitty, *supra* note 7.

149. *Id.*

150. *Id.* As the article states,

> Financial aid administrators use their intimate knowledge of the student loan industry to choose lenders that generally offer the best products and services to most students, but each student's circumstance is different. . . . Many students and parents don't have the time or resources to conduct such a thorough review of the plethora of private loan options and companies. Private lenders offer an array of upfront and back-end benefits and interest rates that can vary depending on the student's credit history, intended major, and institution chosen. Some factors the university considered when selecting lenders for their list would never be considered by students and parents. But ultimately these factors benefit the borrower.

Id.

151. Illegal Inducements and Preferred Lender Lists, FINAID.ORG, http://www.finaid.org/educators/illegalinducements.phtml (last visited Apr. 11, 2008).

152. *Id.*

153. Att'y Gen. of the State of N.Y., In the Matter of SLM Corp., Assurance of Discontinuance, 4 (Apr. 11, 2007), http://www.oag.state.ny.us/family/student_lending/SLM%20Corporation%20Assurance.pdf; *see also* Illegal Inducements and Preferred Lender Lists, *supra* note 151 (stating that "[t]he first lender on a preferred lender list often gets 75% to 95% of the college's student loan volume.").

sinister is at work. Because placement on the lists can result in significant increases in market share, competition for such placement is intense and lenders on some occasions provided institutions various prohibited inducements in exchange for inclusion.[154]

In one instance that received extraordinary attention due to the egregious nature of the allegations, a large public institution systematically placed lenders at the top of the preferred lender list based upon lender inducements. Internal correspondence recovered from one lender "show[ed] that the office and its leadership prioritized lender treats over competitive pricing and borrower benefits in deciding which lenders would be at the 'top of the preferred lender list.'"[155] In formulating the institution's preferred lender list, lenders who provided inducements were given a higher "visibility" score, one of the criteria used for selecting preferred lenders.[156] An internal document described the visibility score as one based on the number of benefits provided to the staff, which the financial aid office tracked on a computer spreadsheet.[157] The benefits included birthday parties, golf tournaments, meals, and bottles of wine and alcohol.[158]

Other examples exist of lenders offering inducements in an effort to secure or maintain placement on preferred lender lists. One lender sponsored a school event at a cost of $50,000, and a representative of the lender later asked for the school to place it on its preferred lender list in return.[159] As previously noted, one lender maintained the top spot on an institution's preferred lender list while the school's financial aid director owned a financial stake in the company.[160] Additional examples exist of conversations in which inducements, such as professional sporting event tickets, meals, and trips, were juxtaposed with conversations of placement on preferred lender lists.[161] Such arrangements have the potential to improperly influence selection criteria for preferred lender lists to the detriment of borrowers relying on the information as an impartial assessment of the financial aid office's research.

The HEA and regulations promulgated thereunder did not address preferred lender lists prior to the recent reforms.[162] The reforms address this area somewhat

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154. Illegal Inducements and Preferred Lender Lists, *supra* note 151 ("There is a lot of competition among lenders in the school relations channel as they try to convince the colleges to add them to the college's preferred lender list.").

155. REPORT ON MARKETING PRACTICES IN THE FEDERAL FAMILY EDUCATION LOAN PROGRAM, *supra* note 84, at 12.

156. *Id.* at 13.

157. *Id.*

158. *Id.* at 12–14.

159. SECOND REPORT ON MARKETING PRACTICES IN THE FEDERAL FAMILY EDUCATION LOAN PROGRAM, *supra* note 115, at 4.

160. REPORT ON MARKETING PRACTICES IN THE FEDERAL FAMILY EDUCATION LOAN PROGRAM, *supra* note 84, at 35.

161. *Id.* at 15–19. The report stated that marketing expenditures were "out of control" and pointed to lender expenditures such as a $1500 meal at Outback Steakhouse, a $21,142 sponsorship of a scholarship luncheon, and a $5000 sponsorship of a golf outing. *Id.* at 14–16.

162. The HEA and regulations promulgated thereunder contained a blanket restriction on the limitation of borrower choice but did not address preferred lender lists with any specificity. *See*

uniformly by requiring various disclosures from lenders and institutions that participate in preferred lender arrangements. The House HEA amendments mandate that all institutions prepare and submit to the Department an annual report for each lender on its preferred lender list.[163] This detailed report must contain information about the loans offered by a lender to students of that institution, including the following:

1. Interest rates, fees, and repayment terms;
2. Forbearance or deferment options;
3. The annual percentage rate of the loan; and
4. The average amount borrowed and average interest rates of similar loans provided to students of the same institution.[164]

The institution must also provide an explanation of why the terms and conditions of each type of loan offered under its preferred lender agreement are beneficial to borrowers.[165] It must make the report available to the public and, in particular, to students or prospective students and their parents.[166] Preferred lender agreements also fall within the auspices of the educational loan arrangement provision of the Senate amendments.[167] The Senate bill would require disclosures similar to those of the House version utilizing a similar model disclosure format and would require the listing of a minimum two to three lenders depending on the program.[168]

The regulations promulgated by the Department impose an additional series of requirements on institutions choosing to provide a preferred lender list.[169] These requirements include the following:

1. The regulations require an institution to place at least three unaffiliated lenders on a preferred lender list;
2. The regulations prohibit institutions from placing lenders on a preferred list that have offered improper inducements to the institution in exchange for placement on the list;

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34 C.F.R. § 682.603(e) (2006).

163. College Opportunity and Affordability Act of 2007, H.R. 4137, 110th Cong. § 153 (2007). The annual report must be submitted using a model disclosure form that will be developed by the Department. *Id.*

164. *Id.*

165. *Id.*

166. *Id.*

167. See *supra* notes 126–129 and accompanying text, for more information about Senate bill provisions relating to educational loan arrangements.

168. Higher Education Amendments of 2007, S. 1642, 110th Cong. §§ 152–153, (2007). On a related note, the competing federal Direct Loan Program does not require that there be any additional lenders aside from the federal government. *Id.*

169. Federal Perkins Loan Program, Federal Family Education Loan Program, and William D. Ford Federal Direct Loan Program, 72 Fed. Reg. 32,410, 32,425 (proposed June 12, 2007) (to be codified at C.F.R. pts. 674, 682, 685). Some argue that the Department lacks the authority to regulate in this area because it is not addressed in the HEA, which is the enabling legislation giving the Department the authority to regulate. *See* Federal Perkins Loan Program, Federal Family Education Loan Program, and William D. Ford Federal Direct Loan Program, 72 Fed. Reg. 61,986 (Nov. 1, 2007) (to be codified at 34 C.F.R. pts. 674, 682, 685).

3. The regulations require an institution to make certain disclosures to borrowers as part of the list. These disclosures include the method used for selecting lenders, comparative information about the benefits and interest rates provided by the lenders, and a "prominent statement" informing the borrower that they are not required to select a lender from the list.[170]

Collectively, the enacted and pending preferred lender list reforms will likely increase transparency, ensure borrowers access to impartial information, and prevent mistrust of the lists and the financial aid offices that produce them.[171]

Despite these benefits, the federal reform effort in the area of preferred lender lists resulted in several negative consequences for borrowers. Most notably, the changes decrease efficiencies in student lending and increase costs to students. As previously mentioned, institutions gain efficiencies in administrative costs by working with a limited number of lenders. For instance, varying lender certification processes and institutional administrative systems make interfacing with too many lenders expensive and complex.[172] Similarly, "[c]ollege [and university] financial aid offices . . . have limited staff available to evaluate the hundreds of lenders and offerings that may change many times a year."[173] Forcing colleges and universities to deal with a certain minimum amount of lenders will increase such administrative costs, which will be passed on to students in the form of higher tuition.

In addition to administrative costs, compliance costs are likely to increase sharply for institutions, at least in the short-term. The Department estimates that changes to the preferred lender regulations alone will increase the compliance burden on institutions by 141,625 hours.[174] This estimate may be conservative when factoring in the legal uncertainty caused by conflicting reform measures and the depth and breadth of the federal reforms. Therefore, while the preferred lender reforms establish an increased level of clarity in some respects, they also have the effect of increasing costs for institutions that will be passed on to students in the form of higher tuition rates.

Additionally, the preferred lender list reforms place an over-emphasis on certain

170. Federal Perkins Loan Program, Federal Family Education Loan Program, and William D. Ford Federal Direct Loan Program, 72 Fed. Reg. at 32,426. The House bill also would require lenders to make certain disclosures. College Opportunity and Affordability Act of 2007, H.R. 4137, 110th Cong. §§ 151–153 (2007). Fundamentally, lenders must disclose information on the model disclosure form to borrowers. *Id.* The lender is required to submit this report to the House of Representatives and Senate committees related to education and also make them available to institutions, other lenders, and the public. *Id.* Additionally, the statute prevents lenders from providing loans to students attending institutions with which the lender has a preferred lender arrangement "until the covered institution has informed the student or parent of their remaining options for borrowing" under the FFEL Program. *Id.* § 152. Furthermore, lenders must certify on an annual basis that any preferred lender relationships satisfy the provisions of the statute. *Id.* §§ 151–152.

171. *See* Chitty, *supra* note 7.

172. Illegal Inducements and Preferred Lender Lists, *supra* note 151.

173. *Id.*

174. Federal Perkins Loan Program, Federal Family Education Loan Program, and William D. Ford Federal Direct Loan Program, 72 Fed Reg. at 32,433.

factors while failing to adequately reflect the importance of others. For instance, the model disclosure requirements essentially espouse a "who has the lowest rate today" line of thinking by prominently featuring interest rate disclosures.[175] While such disclosures are valuable, they fail to reflect a complete picture of the financial aid office's research into the lending industry. In other words, the disclosures de-emphasize important factors such as the overall quality of a lender's product offerings, the value of customer service, the technologies utilized, and the longevity and stability of the lender.[176]

Furthermore, the distrust that investigations and the media frenzy created in financial aid offices, and preferred lending lists in particular, causes students to seek advice from other, less informed sources. One source is direct-to-consumer advertising from lenders, which in some cases may contain misleading information or improper incentives.[177] Another source is third party student loan comparison sites, which purport to impartially provide prospective students with data about student loan offerings.[178] The objectivity of these services is questionable, however, because revenue models for the services are based on fees from lenders and advertising campaigns.[179] The reform measures thus undercut the superior and more holistic judgment of financial aid offices, which are better positioned to analyze lending options and consider student needs. Taken together with the aforementioned unintended consequences, these shortcomings offset many of the benefits of preferred lender list reforms.

C. Enforcement

In addition to providing more clarity on inducements and preferred lender lists, the House amendments and regulations provide the Department with additional enforcement mechanisms to ensure transparency and prevent conflicts. As a threshold issue, the House legislative proposal would require that program participants comply with HEA provisions as a condition to receiving federal funds.[180] The amendment also would enable the Department to penalize lenders and institutions that violate the HEA. Specifically, lenders would face the limitation, suspension, or termination of participation in the program for violations of the statute while institutions could face civil penalties up to $25,000 for

175. See *supra* notes 163, 170 and accompanying text, for more information on disclosure requirements.

176. By placing an emphasis on the disclosure of certain limited factors, the reforms necessarily fail to account for other factors that financial aid offices consider. See generally *Guide to Developing a Preferred Lender List*, *supra* note 9, for a discussion of such factors.

177. *See* Press Release, Andrew M. Cuomo, *supra* note 68. Cuomo claims a "spike in misleading and deceptive practices in the direct marketing segment of the student loan industry" following government reforms of preferred lender arrangements. *Id.*

178. Andy Guess, *'Consumer Reports' for Student Loans*, INSIDE HIGHER ED, Oct. 22, 2007, http://www.insidehighered.com/news/2007/10/22/preferred.

179. *Id.*

180. College Opportunity and Affordability Act of 2007, H.R. 4137, 110th Cong. § 156, (2007).

violations.[181]

Aside from these threshold changes, the implementing regulations would make three changes to improve enforceability of the inducement provisions. First, and most significantly, the rules would create a rebuttable presumption that any prohibited payment or activity by the lender is done for the purpose of securing additional FFEL Program loan volume.[182] This change places the burden on the lender to prove that it undertook a specific activity or made a payment for a purpose other than to secure additional loan volume.[183] Second, the new enforcement regulations would disqualify from guaranty any loans obtained through the program by improper inducement.[184] In other words, any improperly obtained loan would not be eligible for federal subsidy payments under the FFEL program. Third, the proposed regulations would clarify and expand the borrower's legal rights.[185] The most significant advance in borrower's rights is the application of the Federal Trade Commission's Holder Rule, which subjects the lender to any of the claims or defenses that the borrower may have against the institution to all loans under the FFEL Program.[186] Collectively, these changes have the potential to lead to more effective oversight of the FFEL Program if utilized appropriately and consistently by the Department.

While effective oversight serves the long-term interest of the FFEL Program, many lenders and institutions expressed concern with the use of a rebuttable presumption standard for determining whether a particular activity qualifies as an inducement. Specifically, respondents to the proposed regulations "argued that the use of a rebuttable presumption [is] inconsistent with the statutory requirement that the [Department] determine that an inducement was offered in order to secure loan applications."[187] The Department defends this standard by arguing that the rebuttable presumption does not relieve the Secretary of Education's burden to show that a lender offered an inducement for the purpose of securing additional loan volume.[188] Instead, once the Department identifies a prohibited inducement, it merely places the burden on the lender to show that the inducement was not offered for the purpose of securing loans.[189]

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181. *Id.*

182. *See* Federal Perkins Loan Program, Federal Family Education Loan Program, and William D. Ford Federal Direct Loan Program, 72 Fed. Reg. 32,410, 32,420 (proposed June 12, 2007) (to be codified at C.F.R. pts. 674, 682, 685).

183. *Id.* See *infra* notes 187–194 and accompanying text, for a discussion of how this is a controversial provision of the new regulations.

184. Federal Perkins Loan Program, Federal Family Education Loan Program, and William D. Ford Federal Direct Loan Program, 72 Fed. Reg. at 32,420.

185. *Id.*

186. *Id.*

187. Federal Perkins Loan Program, Federal Family Education Loan Program, and William D. Ford Federal Direct Loan Program, 72 Fed. Reg. 61,960, 61,976 (Nov. 1, 2007) (to be codified at 34 C.F.R. pts. 674, 682, 685).

188. *Id.* Several opponents also made the argument that the Department exceeded its regulatory authority. The Department argued that the establishment of a rebuttable presumption is within its legal authority. *Id.*

189. *Id.*

Notwithstanding the Department's argument, the use of a rebuttable presumption increases uncertainty for lenders and institutions engaged in often-complex relationships. As a result of the broad definition of prohibited inducements and the rebuttable presumption standard, "a number of activities would automatically be presumed by the Department to be a violation."[190] As an example, National Association of Student Financial Aid Administrators (NASFAA) Chairman Michael Bennett points to the wide range of philanthropic activities engaged in by lenders, predominantly for reasons other than securing additional loan volume.[191] Even for donations unrelated to securing loan volume, a lender could be faced with the task of defending its actions at great expense.[192] This automatic presumption waters down the statute's quid pro quo requirement and has the potential to unfairly restrict lender activities on campus related to the creation of goodwill or general marketing.[193]

Additionally, no rule or legislative enactment will per se guarantee uniform oversight and enforcement in the FFEL Program. The current environment of controversy may actually increase the odds of inconsistent enforcement as external pressures may cause the Department to overreact by "reflexively imposing large administrative fines against our nation's colleges or by unreasonably limiting, suspending or terminating . . . lenders."[194] In order to give meaning to reforms, the Department must issue timely guidance, ensure effective oversight, and enforce guidelines fairly and consistently. Lenders and institutions have a right to the certainty that the program previously lacked in determining how to structure relationships with institutions that will provide the maximum benefit to borrowers.

190. *Id.*

191. Posting of Michael Bennett to National Chair's Blog, http://nasfaachair.org/blog/?p=9 (Nov. 27, 2007, 05:00 EST).

192. *See id.*

193. Jonathan Vogel, *What's Ahead on Student Loans in 2008*, INSIDE HIGHER ED, Jan. 3, 2008, http://www.insidehighered.com/views/2008/01/03/vogel.

194. *Id.*

IV. ENSURING COMPLIANCE

Although the revised regulations do not take effect until July 2008 and the final contents of any HEA amendment is uncertain, the reform proposals provide a good roadmap for institutions to implement reform.[195] Specifically, institutions can guard against conflict and prepare for reforms to take effect by comprehensively reviewing current practices, updating financial aid office standards, and establishing protocol for periodic review. In some instances the recent reforms facilitate these processes by laying out specific standards or model processes to accomplish these tasks. In others, the reforms create new problem areas that institutions must overcome.

The process should begin with a comprehensive review of current practices. As a starting point, institutions should review existing contracts and arrangements with lenders. This review should ensure that these relationships comply with updated reform measures and do not create the appearance of conflicts of interest.[196] Similarly, institutions should question financial aid office employees to obtain any information about existing or potential conflicts of interest.[197] Mechanisms should be established for the continuous review for conflict in these areas and institutions should put disclosure and approval procedures in place to deal with potential conflicts.

Following a comprehensive review of practices, institutions should ensure that all standards meet or exceed updated guidelines. The primary area of importance in this respect is the financial aid office code of conduct. As a starting point, the code of conduct should comply with any applicable state and federal laws and regulations. Importantly, the integrity provisions of the House HEA amendments would mandate that schools develop such codes of conduct for officers,

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195. Congress was working towards a March 31, 2008 deadline to reconcile the differences between House and Senate versions of the bill, but significant differences remain. Nathan C. Strauss, *Bush Criticizes Updated Higher Ed Bill*, HARV. CRIMSON, Feb. 12, 2008, *available at* http://www.thecrimson.com/article.aspx?ref=521841. The possibility of a veto from the White House looms as well, with President Bush opposing significant portions of the House bill. Specifically,

> the Administration strongly opposes House passage of H.R. 4137, the "College Opportunity and Affordability Act of 2007," as reported by the Committee on Education and Labor, because it would restrict the Department of Education's authority to regulate on accreditation; create nearly four dozen new, costly, and duplicative Federal programs; condition receipt of Federal grant funding on tuition price; and restrict the Department's ability to evaluate and effectively manage Upward Bound and other TRIO programs.

OFFICE OF MGMT. & BUDGET, EXEC. OFFICE OF THE PRESIDENT, STATEMENT OF ADMINISTRATION POLICY: THE COLLEGE OPPORTUNITY AND AFFORDABILITY ACT OF 2007, FISCAL YEAR 2008 (Feb. 6, 2008), *available at* http://www.whitehouse.gov/omb/legislative/sap/110-2/saphr4137-r.pdf. Despite this legal uncertainty, the various reform measures are a good indication of the federal government's approach to eliminating conflicts of interest in the FFEL Program and collectively provide a good basis for institutional reforms. *Id.*

196. Illegal Inducements and Preferred Lender Lists, *supra* note 151 (containing the section entitled *Tips for Avoiding Conflicts of Interest*).

197. *Id.*

employees, and agents.[198] The amendment would require that institutions publish the code on the institution's website and that it be designed in accordance with the statute to prohibit conflicts on interest.[199]

More specifically, the code should be comprehensive, yet well written and easy to understand. It should contain as many bright-line rules as feasible and avoid complicated legalese.[200] It should also afford due process protections and "clearly identify the types of conduct proscribed, the disclosures required, the procedures observed to investigate complaints, and the sanctions used to punish violations."[201] Although it may be impossible to predict with certainty whether the code of conduct requirement will make it into the final bill, it provides a good model and is indicative of Congress' expectations for compliance.[202]

Additionally, institutions should allocate adequate resources for training and enforcement related to the code of conduct. The code will play only an insignificant role in preventing conflicts of interest if colleges and universities fail to properly train employees on compliance with the code's mandates.[203] Failure to do so could also violate federal law as the House HEA amendments would

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198. College Opportunity and Affordability Act of 2007, H.R. 4137, 110th Cong. § 156 (2007).

199. *Id.*

200. Vincent R. Wilson, *Corruption in Education: A Global Legal Challenge*, 48 SANTA CLARA L. REV. 1, 33 (2008). "Whenever possible, [codes of conduct] should contain bright-line rules and never three-armed lawyer gobbledygook–that is, on the one hand this, on . . . the other hand that, and on the third hand something else." *Id.*

201. *Id.*

202. Institutions may also look to other sources in an effort to develop a more comprehensive code of conduct. One such source is the College Loan Code of Conduct, which the New York Attorney General's office created in response to its investigation of student lending practices. Press Release, Andrew M. Cuomo, N.Y. State Att'y Gen., Office of N.Y. State Att'y Gen., College Loan Code of Conduct (2007), *available at* http://www.oag.state.ny.us/family/student_lending/College%20Code%20of%20Conduct.pdf. In many respects, the provisions of this code overlap with the statutory provisions of the federal law; however, the New York code goes a bit further and serves as a good supplement to the federal requirements. The code establishes prohibitions on revenue sharing, gifts and trips, and advisory board compensation. *Id.* It also requires that institutions make certain disclosures to students and parents. *Id.*

An additional resource is the code of conduct published by the National Association of Student Financial Aid Administrators (NASFAA). NAT'L ASS'N OF STUDENT FIN. AID ADM'RS, NASFAA'S STATEMENT OF ETHICAL PRINCIPLES AND CODE OF CONDUCT FOR INSTITUTIONAL FINANCIAL AID PROFESSIONALS (2007), *available at* http://www.nasfaa.org/subhomes/mediacenter/nasfaacodeofconduct.pdf. This code establishes ethical principles and a code of conduct for financial aid employees. The ethical principles outlined in the guide include providing students and parents with useful information, protecting the privacy of student records, ensuring equity, and committing to a high level of ethical behavior. *Id.* The code of conduct establishes professional standards for financial aid employees. *Id.* Specifically, the code prohibits financial aid employees from acting in their own interests, acting contrary to law or the interests of the student, and from accepting anything "of other than nominal value from any entity." *Id.* Additionally, the code implores that employees maintain objectivity when dealing with any entity related to the making of student loans. *Id.* There is also a disclosure requirement that requires the employee to disclose to the institution any involvement in any entity involved in student aid. *Id.*

203. Wilson, *supra* note 200, at 40.

establish training and compliance requirements. The integrity provisions require institutions to "administer and enforce [the] code of conduct . . . by, at a minimum, requiring all of its officers, employees, and agents with responsibilities with respect to educational loans to obtain training annually in compliance with the code."[204] In the current dynamic environment, exceeding this minimum requirement by requiring more frequent training places a relatively low administrative burden on the institution and will ensure that employees are aware of all changing laws and regulations affecting their duties.

Colleges and universities should also ensure compliance with reform measures by performing a comprehensive review of procedures for developing preferred lender lists.[205] Appropriately developed and researched lists "can serve as a source of unbiased information that facilitates rather than limits informed borrower choice."[206] To guard against conflicts of interest, preferred lenders lists should be developed at arms-length according to statutory and regulatory guidelines, the merits of the lender's proposals, and an objective system of evaluation focused on benefits to the borrower.[207]

Developing an objective system of review essentially depends on two factors: objective criteria for lender inclusion on the preferred lender list and objective decision-making. First, institutions should develop a uniform procedure for evaluating lenders. The evaluations should be based on factors such as lender stability, the quality of the lender's products, customer service ratings, and operational standards.[208] Institutions should weight and score these criteria to arrive at a total score for each lender and choose at least three unaffiliated lenders that score highest in evaluations.[209] When published, the list should contain the disclosures required by law in an easy to read, accessible format.

Additionally, institutions can ensure objective decision-making throughout the process by spreading out the authority to make decisions regarding the preferred lender lists. This may be accomplished by appointing a panel composed of several people who will be tasked with developing the selection criteria and methods and, ultimately, the lenders that will be included on the preferred lender list. For instance, one institution utilizes a nine-member panel to review and rank proposals from different lending companies based upon pre-determined criteria.[210] The panel should review the list annually to ensure that the selection criteria and methods are adequate and that the lenders on the preferred lender list represent the best options for borrowers.

Even after adopting such changes, institutions should strive for continuous

204. College Opportunity and Affordability Act of 2007, H.R. 4137, 110th Cong. § 155 (2007).

205. *See Guide to Developing a Preferred Lender List*, *supra* note 9, at 8.

206. Federal Perkins Loan Program, Federal Family Education Loan Program, and William D. Ford Federal Direct Loan Program, 72 Fed. Reg. 61,960, 61,987 (Nov. 1, 2007) (to be codified at 34 C.F.R. pts. 674, 682, & 685).

207. *See Guide to Developing a Preferred Lender List*, *supra* note 9, at 9–10.

208. *See id.* at 2–3.

209. *See id.* at 8.

210. Chitty, *supra* note 7.

improvement of processes and procedures. The regulatory environment is uncertain and there is no way to determine what will ultimately emerge from pending legislation.[211] Institutions should monitor developments in this area closely and ensure that codes of conduct and preferred lender practices are in compliance with current federal and state law and Department regulations. Implementing these practices will ensure that the process is transparent and will allow financial aid offices to continue serving vital advisory roles for students faced with the difficult task of financing higher education.

CONCLUSION

Financial aid offices play a critical role in improving access to higher education by helping students navigate through the financial aid process to secure the necessary funding to attend colleges and universities. Transparency and objectivity are both central components in ensuring that students are able to properly utilize this resource. While the regulatory and legislative reform measures facilitate these goals, they are poorly conceived in many respects. Specifically, the reforms create legal uncertainty and ultimately harm borrowers by creating higher costs, impediments to access, instability in the private lending industry, and a reduction in the quality of product offerings and services. The frenzied nature of the reform effort also undermined trust in an entire profession based upon the misdeeds of a handful of people. A more thoughtful and collaborative government response could have avoided such problems.

These shortcomings underscore the need for further study and policy analysis of the FFEL Program framework, and particularly the value of public-private relationships. The goal of keeping ethical lines clear is indeed commendable, but more emphasis should be placed on a balanced support for the longstanding, proven public-private partnership approach, which yields reasonable resources for financing higher education costs at relatively modest taxpayer expense. In the interim, institutions can do their part by thoroughly reviewing policies and procedures, revising practices to comply with reforms, and investing appropriate resources in training and continuous improvement. Those institutions that are committed to fostering public-private partnerships that are beneficial to borrowers will be in the best position to ensure greater access to higher education and restore credibility to the valuable role that financial aid offices serve for borrowers.

211. *See supra* note 195 (discussing the legal uncertainty surrounding pending reform proposals).