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COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

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B-117604(7)

SEP 20 1972

Dear Mr. Secretary:

We have received your comments, dated March 20, 1972, on our report issued to the Congress entitled "Office of Education Should Improve Procedures to Recover Defaulted Loans Under the Guaranteed Student Loan Program." (B-117604(7), Dec. 30, 1971.)

In your comments you state that you have completed your study of legal matters and that you differ substantively with three of our recommendations. Our reply is enclosed.

Copies are being forwarded to the Director, Office of Management and Budget; the House and Senate Committees on Government Operations; the Committees on Appropriations; and the Commissioner of Education, Department of Health, Education, and Welfare.

Sincerely yours,

Acting Comptroller General
of the United States

Enclosure

The Honorable
The Secretary of Health, Education,
and Welfare

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REPLY TO THE DEPARTMENT OF

HEALTH, EDUCATION, AND WELFARE

ON RECOMMENDATIONS MADE

IN OUR REPORT TO THE CONGRESS

B(1) and (2)

We recommended that the Secretary of Health, Education, and Welfare urge the Office of General Counsel and the Office of Education (OE) to take prompt action to:

1. Issue instructions or guidelines concerning the liability of all parties so that piecemeal collection action may be avoided.

2. Protect the interest of the United States when State laws require that the original promissory note be surrendered upon execution of an installment note.

DEPARTMENT COMMENT

"With respect to item 1 above we do not concur in the need for the issuance of guidelines for the following reasons:

"a. The Act contemplated a single maker, i.e., the student borrower and permits endorsement only in cases where the borrower's infancy would preclude his entering into a legally binding commitment. The situation, therefore, is not one of 'jointly and severally' liable parties but rather one where the maker is principally liable and an endorser, if any, secondarily liable.

"b. The program regulations permit but do not require endorsement (45 C.F.R. 177.46(b)) where the borrower is a minor and cannot legally be held on the note, since in many cases to do so would result in a student's inability to secure the financing necessary for his education due to the lack of the endorsement. In addition, in many jurisdictions the laws normally

relating to infancy as a bar against enforcement of a contract have been abridged so as to make legally binding the obligations of a minor which are incurred for the purpose of pursuing higher education.

"c. We do not believe that claims should be made against parents or spouses who are not endorsers on the note. To press a claim against a spouse under circumstances where the borrower was not a minor, would seem to clearly run afoul of the intent of the statutory prohibition against securing an endorser on the obligation. In the case of a borrower who is a minor and where the statute permits securing endorsement on the obligation, we believe that where it is contemplated that parents are to be held liable for their child's obligation, the lender should secure their endorsement on the obligation. As a corollary where endorsement is not secured, we do not believe it is necessary or appropriate that the lender make a written demand on the borrower's parents before presenting his claim to the United States."

GAO REPLY

A literal construction of the statute (20 U.S.C. 1077(a)(2)(A)) precludes the insuring of a student loan evidenced by a note bearing an endorsement unless the student is incapable of entering into a binding obligation. We concur, therefore, in your view that the act permits an endorsement only in cases in which the borrower's infancy would preclude his entering into a legally binding commitment. Even then an endorsement is not required.

We agree also with your opinion that no demands be made on a parent unless the note contains his signature even though under some State laws a minor cannot be held legally liable on his note. The fact remains that, at the time of our review, the promissory notes of 78 of the 219 students had been cosigned. Of these 78 students, 31 were minors, six were of unknown age, and 41 had reached their majority.

We found nothing in the act or in the legislative history indicating an intent on the part of the Congress to relieve any cosigner or endorser of liability arising from his act of obligating himself on a note. Since many of the notes we reviewed had been cosigned and the Office of Education was not proceeding against the cosigners, our report to the Congress (p. 14) brought out this fact. We recommended that guidelines be issued so that collection action could be taken simultaneously against all liable parties in accordance with the Federal Claims Collection Act and the implementing Joint Standards.

It is now our view that, if a student has reached his majority at the time he obtains the loan and an endorser is secured on the note, the act precludes the guaranty of the loan. It follows, therefore, that under the Guaranteed Student Loan Program, the loans of the 41 students mentioned above, who had reached their majority, were improperly insured.

Under the circumstances, we are now of the opinion that a demand should not be made on a cosigner or endorser on a note, except when an endorsement is permitted, even though the Government did insure the loan and make good on its guaranty.

To eliminate the possibility of loans under the Guaranteed Student Loan Program being improperly insured in the future, we recommend that guidelines be issued as soon as practicable setting forth the requirements which are necessary for a loan to be properly insured. Lenders should be made aware that the act precludes the insuring of a student loan evidenced by a note bearing an endorsement unless the student is incapable of entering into a binding obligation.

DEPARTMENT COMMENTS

> "Regarding Item 2 above, we do not believe that the installment note (OE Form 1171) provided by the Government amounts to a substitution for the promissory note (OE Form 1164) executed by the borrower which would have to be surrendered under the law of any State. The promissory note which contains all of the terms and conditions of the loan including the maximum and minimum permissible length of the repayment period, specifically provides that the repayment

of principal and interest will be made in periodic installments in accordance with 'either (1) a repayment schedule to be provided by the lender prior to the commencement of the repayment period which will be made a part of this note, or (2) the terms of a separate instrument which shall be subject to the terms of this note and which the borrower agrees to execute prior to commencement of the repayment period.' Accordingly, even under the second option, it is clear that the 'separate instrument' merely amounts to a repayment schedule. The 'separate instrument' which the borrower agrees to execute is not, therefore, a substitute obligation, but rather a supplemental document and we would see no basis for any endorser on the basic promissory note being released from his obligation, upon execution of this additional document. In any event, if a lender has secured endorsement on the original promissory note and has difficulty in again securing that endorsement on a separate instrument reflecting the repayment schedule, as the above-quoted portion of the note indicates, the lender has the option of merely attaching a repayment schedule to the original promissory note. We would note that such a schedule will have to be prepared by the lender anyway in order to comply with the truth in lending requirements."

GAO REPLY

We have not examined the law of each individual State to determine the accuracy of your statement that you do not believe the installment note amounts to a substitution for the promissory note which would have to be surrendered under the law of any State. The significant fact is that, in many of the cases we reviewed, the promissory note had been surrendered after execution of the installment note.

We pointed out on page 15 of our report that the installment note specifically provides that the undertaking of the maker under such installment note is "in satisfaction of his existing obligation to repay sums advanced to him by the lender as evidenced by the promissory note." The most reasonable view of the installment note is that it completely satisfies the original obligation and that any legal enforcement action would be only on the installment note and not on the original promissory note.

Under the Uniform Commercial Code, article 3, part 6, the liability of all parties is discharged when any party who has himself no right of action or recourse on the instrument reacquires the instrument in his own right. It follows that any endorser, whose signature was obtained on the original note because the student did not have the legal capacity to enter into a binding agreement, could not be held liable in case of default if the original note was surrendered and his signature was not obtained on the installment note.

We know of no practical way of establishing or enforcing liability against the parties on the original promissory note after it has been surrendered. It seems to us that the Government's interest requires that whenever an installment note containing a provision to the effect that it is in satisfaction of the original obligation under the promissory note, or whenever such original note is surrendered, then the signatures of all liable parties on the original note must be obtained on the installment note. Otherwise, the repayment schedule should be attached to the original promissory note.

DEPARTMENT COMMENT ON C

> "We are considering the possibility of formulating a refund policy which will be fair to the student, the lender, and the Office of Education. However, the establishment and enforcement of a national refund policy in the field of higher education presents questions that reach far beyond limiting the exposure of the United States on loans guaranteed under Title IV-B of the Higher Education Act. We hope to resolve these questions in the near future."

GAO REPLY

Our recommendation was that, to the maximum extent practicable, a national refund policy in the Guaranteed Student Loan Program be established.

The Department has indicated that the only apparent route short of legislation would be to have accrediting agencies and associations, in order to be recognized by the Commissioner as "nationally recognized" agencies and associations, require that colleges as a condition of accreditation adopt uniform standards and procedures for refunds. The Department, while admitting that the Commissioner does set standards for qualifying

for national recognition, feels it is doubtful that such standards could legitimately compel institutional compliance with uniform standards and procedures governing refunds which are set by the Commissioner.

We understand that early in 1971 the Bureau of Higher Education made proposals for additional legislative requirements relative to the determination and termination of institutional eligibility and included therein a proposal on the enforcement of a pro rata student tuition refund policy.

The Bureau felt that, under the present statutory provisions governing institutional eligibility for federally funded education programs, the interests of the Federal Government and the students were not being protected. The Bureau felt also that the eligibility requirements which were included in its proposal would create safeguards to insure that the interests of students and the Federal Government are protected and would provide the power and authority to the Commissioner of Education to terminate eligibility.

We have no objection to the Commissioner's seeking enactment of appropriate legislation if he deems it desirable to have such a policy established by the Congress rather than by administrative action.

We should also like to add that during our review we learned that several studies had been made in connection with refund policies and that, following a September 1968 meeting of the Advisory Committee, the Commissioner of Education adopted the following policy regarding refunds:

> "For the time being, the Office of Education shall follow the Veterans' Administration precedent and accept a school's accredited status as qualification without examination of refund policy, but should establish a refund policy for schools participating in the loan program which gain entry via substitute routes for accreditation. This policy should incorporate a general pro rata model for refund of tuition fees."

During the same September 1968 meeting, a proposal was made that OE:

> "Propose a universal refund policy, sufficiently broad in scope and high in standard, to protect students from all types of schools participating under the various educational aid programs, and persuade recognized accrediting organizations to adopt such a uniform refund policy."

We learned that, during the summer of 1969, the Accreditation Policy Unit, Bureau of Higher Education, made a study of refund policies in a random sampling of 140 institutions of higher education. Of these 140, 38 did not have catalogues on file with the Accreditation and Institutional Eligibility Staff. Of the other 102 institutions, 76 had refund policy information but, in general, they set deadlines giving the maximum time within which one could withdraw from an institution or course and still receive a portion of the tuition paid, 14 did not state whether or not a policy existed for refunds, and 12 stated that they did not provide a refund policy.

It definitely appears that there is an awareness of the necessity for a national refund policy and that sufficient study has already been made for action to be taken without further delay, either through legislation or by the indirect short route mentioned in the Department comments.

One of the more significant matters pertaining to a refund policy to which we called attention in our report involves paying refunds to students or to their next of kin (in the case of deceased students) rather than applying such refunds in liquidation of the guaranteed-loan indebtedness. When a student fails to complete his training which results in the schools' making a partial refund of tuition and other costs, it is inconceivable that the refund should be paid to the student, leaving to chance the possibility of the Government's recovery at a later date.

It is our view that any portion of a guaranteed loan that is not used for educational purposes should be applied to liquidate the loan indebtedness. Even if the reason for failure to complete the schooling is due to permanent disability or death, we find no justifiable basis for the Government bearing the loss by agreeing that the educational institution pay to

the disabled student or next of kin, as applicable, any refund which may be due.

In order to rectify this situation, serious consideration should be given to requiring the student at the time of obtaining the insured loan to execute an assignment in favor of the lending institution of the student's right, title, and interest in any refund (incident to his failure to complete his training) to which he thereafter might be entitled from the educational institution concerned and to require that a copy of this assignment be transmitted by the lending institution to the educational institution.

Under this procedure the student would be made aware of his nonentitlement to refund, the lending institution would have assignment rights, and the educational institution would be put on notice that any refunds due must be transmitted to the lending institution in accordance with such assignment. You may wish to consider incorporating the assignment in the promissory note itself in which event a copy of the note should be transmitted to the educational institution.