



SAFEGUARDING FEDERAL FINANCIAL AID FROM FRAUD AND ABUSE

April 23, 2004

During reauthorization of the Higher Education Act, Congress has the opportunity to make higher education more accessible for underserved students, including many working adults and older youth. We urge Congress to seize this opportunity—but with caution. Innovations and reforms must be balanced against the danger of repeating past abuses. Students and taxpayers must be protected from unscrupulous schools that are in business not to educate but to chase federal dollars.

The History of Fraud and Abuse

Congressional hearings during the 1990s documented extensive abuses, primarily by proprietary (for-profit) schools participating in federal student loan and grant programs. The abuses by these schools included:

- Setting tuitions at artificially high levels;
- Disbursing funds to ineligible students, including illiterate students;
- Fraudulently administering ability-to-benefit tests;
- Closing without warning;
- Paying brokers to sign up students, then filling out grant applications without regard to whether students actually enrolled or not;
- Falsifying and even forging documents to obtain federal funding for students;
- Providing woefully inadequate instruction; and
- Using federal funds to support school owners' lavish lifestyles.

The Federal Response

Congress and the Department of Education eventually addressed these terrible abuses, passing targeted protections to assist victims and prevent future problems. These protections included:

- **Default Rate Sanctions:** Penalizing schools with consistently high loan default rates.
- **The 90/10 (formerly 85/15) Rule:** Requiring schools to limit the percentage of revenues received from federal financial assistance to no more than 90 percent.
- **Limits on Correspondence and Telecommunications Courses:** Prohibiting schools from providing half or more of their students' coursework through correspondence or telecommunications classes or having half or more of their students enrolled in such classes.
- **Minimum Instructional Time Requirements.**
- **Minimum Completion and Job Placement Rate Requirements.**
- **Incentive Compensation Ban:** Prohibiting commissions, bonuses, and other incentive payments to school employees and recruiters.
- **Limited Loan Forgiveness for Victims of Fraud:** Writing off federal loans for many of the students hurt by school closings, false certifications of eligibility, and unpaid refunds.

The good news: Many of these laws were aggressively enforced and helped curb fraud and abuse, particularly in the proprietary school sector.

The bad news: Although serious problems still exist, many of these protections have been substantially weakened or eliminated. Others are currently under attack. For example, Congress and the Department have steadily expanded the ability of schools to appeal their default rate and have eliminated certain types of loans from the default rate calculations. In addition, current legislation proposes to eliminate the 90/10 rule; and the Department, through its own rulemaking, added 12 major loopholes to the incentive compensation ban.

Current Problems

“While the Department has made some progress, reducing risk in the student aid programs continues to be a management challenge for the Department.”—*Office of Inspector General, September 2003 Semiannual Report.*

Just in 2003, the Department of Education’s Office of Inspector General (OIG) made public seven audits documenting serious fraud and abuse in school administration of federal student aid programs. The Department recommended that those schools cumulatively return over \$15 million to the Department, lenders, and students. Also in 2003, the Department’s Office of Hearings and Appeals, in 10 separate decisions, ordered schools to return over \$3.3 million. And these are just the schools that the Department investigated.¹ Problems cited included:

- Schools closing without warning;
- Routine fabrication of financial aid documents;
- Falsification of ability-to-benefit test results;
- Widespread failure to comply with the 90/10 rule;
- Overstating program length; and
- Disbursing funds to ineligible students.

In addition, in an August 2002 audit, the OIG found that the Department did not have an effective monitoring system in place to ensure that approved ability-to-benefit test publishers comply with applicable laws.

These problems are not confined to the federal loan programs. Especially in the last few years, serious problems have emerged in the private student lending sector. For example, a 2003 survey by the National Association of State Administrators and Supervisors of Private Schools showed that in 2002 over 100 computer training schools closed in the 23 states that responded to the survey. Of those schools, only 25 provided any advance notice of the closing.

Recommendations: Where Do We Go From Here?

- Immediately undertake a non-partisan study of current fraud and abuse in federal financial aid programs and of the effectiveness of the current protections.
- Preserve the protections that have been effective in curbing fraud and abuse.
- Restore the most effective protections, such as cohort default rates and incentive compensation, to full strength.
- Consider changes to existing protections on a demonstration project basis only and carefully measure the results of these projects. For example, the Distance Education Demonstration Project has played an effective gate-keeping role in testing the distance education waters without opening the door to widespread fraud and abuse.

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¹ These numbers are based on a review of the audits and hearing decisions related to “Federal Student Aid” that were posted on the Department’s website. In many cases, the schools did not agree with the audit results.