Fifth Third Bank’s Eligible Lender Trustee Agreements
Compliance with Lender Provisions of
the Higher Education Act and Monitoring of
Entities With Which It Has Agreements

FINAL AUDIT REPORT

ED-OIG/A09H0017
January 2009
Statements that managerial practices need improvements, as well as other conclusions and recommendations in this report, represent the opinions of the Office of Inspector General. Determinations of corrective action to be taken will be made by the appropriate Department of Education officials.

In accordance with the Freedom of Information Act (5 U.S.C. § 552), reports issued by the Office of Inspector General are available to members of the press and general public to the extent information contained therein is not subject to exemptions in the Act.
Dear Mr. Gardner:

Enclosed is our final audit report, Control Number ED-OIG/A09H0017, entitled *Fifth Third Bank’s Eligible Lender Trustee Agreements Compliance with Lender Provisions of the Higher Education Act and Monitoring of Entities With Which It Has Agreements*. This report incorporates the comments you provided in response to the draft report. If you have any additional comments or information that you believe may have a bearing on the resolution of this audit, you should send them directly to the following Education Department official, who will consider them before taking final Departmental action on this audit:

James Manning  
Acting Chief Operating Officer  
Federal Student Aid  
U.S. Department of Education  
Union Center Plaza, Room 112G1  
830 First Street, NE  
Washington, D.C. 20202

It is the policy of the U. S. Department of Education to expedite the resolution of audits by initiating timely action on the findings and recommendations contained therein. Therefore, receipt of your comments within 30 days would be appreciated.

In accordance with the Freedom of Information Act (5 U.S.C. § 552), reports issued by the Office of Inspector General are available to members of the press and general public to the extent information contained therein is not subject to exemptions in the Act.

Sincerely,

/s/  
Gloria Pilotti  
Regional Inspector General for Audit

Enclosure
## TABLE OF CONTENTS

<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>EXECUTIVE SUMMARY</td>
<td>1</td>
</tr>
<tr>
<td>BACKGROUND</td>
<td>3</td>
</tr>
<tr>
<td>AUDIT RESULTS</td>
<td>4</td>
</tr>
<tr>
<td>FINDING NO. 1 – Fifth Third Bank, as an ELT, Violated the Prohibition</td>
<td>4</td>
</tr>
<tr>
<td>on Offering Inducements</td>
<td></td>
</tr>
<tr>
<td>FINDING NO. 2 – Fifth Third Bank’s Policies and Procedures for</td>
<td>14</td>
</tr>
<tr>
<td>Monitoring its ELT Agreements Need To Be Improved</td>
<td></td>
</tr>
<tr>
<td>OTHER MATTER</td>
<td>19</td>
</tr>
<tr>
<td>OBJECTIVES, SCOPE, AND METHODOLOGY</td>
<td>20</td>
</tr>
<tr>
<td>ENCLOSURE 1: Fifth Third Bank’s ELT Agreements as of June 30, 2007</td>
<td>21</td>
</tr>
<tr>
<td>ENCLOSURE 2: Fifth Third Bank’s Comments on the Draft Report</td>
<td>23</td>
</tr>
<tr>
<td>ENCLOSURE 3: SLX’s Comments on the Draft Report</td>
<td>75</td>
</tr>
</tbody>
</table>
EXECUTIVE SUMMARY

Fifth Third Bank is an eligible lender in the Federal Family Education Loan (FFEL) Program. As an eligible lender, Fifth Third Bank entered into trust arrangements with other entities which allowed the other entities to originate or purchase student loans. The purpose of the audit was to 1) determine whether Fifth Third Bank, as the eligible lender trustee (ELT) in agreements with other entities, adhered to the prohibitions on inducements specified in § 435(d)(5) of the Higher Education Act (HEA), and 2) assess Fifth Third Bank’s monitoring activities for ensuring that entities, with which it has ELT agreements, have adhered to applicable requirements of the FFEL Program. Our review covered Fifth Third Bank’s ELT agreements with other entities that originated or held FFELs under the associated lender identification numbers (LIDs) during the period from July 1, 2006 to June 30, 2007.

Under § 435(d)(5) of the HEA, a lender may be disqualified from participation in the FFEL Program if it offers points, premiums, payments, or other inducements, to any educational institution or individual in order to secure applications for loans. We concluded that Fifth Third Bank, as the ELT in agreements with other entities, violated this provision. Fifth Third Bank and Student Loan Xpress, Inc. (SLX) had jointly entered into separate ELT agreements with three entities: MSA Solution, Inc. (MSA), Pacific Loan Processing, Inc. (PLP), and Law School Financial (LSF). The ELT agreements specified that SLX (a named party to the trust) will pay a premium (inducement) to the other entity named in the trust (i.e., MSA, PLP, LSF) for loans originated under the ELT agreement based on the loan principal. Our review of Fifth Third Bank’s other ELT agreements disclosed arrangements that also included the offering of inducements, which we discuss in the OTHER MATTER section of the report. We will be referring these ELT agreements to the Department for further review. Nothing came to our attention to indicate that Fifth Third Bank’s ELT agreements included activities that would violate the other three prohibited practices listed in § 435(d)(5) of the HEA.

We also found that Fifth Third Bank needs to improve its monitoring of the entities with which it has ELT agreements. Fifth Third Bank did not have written policies and procedures for evaluating the entities and monitoring their activities. It also did not maintain adequate documentation of its evaluation and monitoring efforts.

We recommend that the Acting Chief Operating Officer for Federal Student Aid (FSA) terminate Fifth Third Bank’s participation in the FFEL Program under the three ELT agreements and take other appropriate action to address Fifth Third Bank’s violation of the inducement provision, which could range from assessing a fine to terminating the Federal reinsurance on the over $3 billion of FFELs originated under the agreements. We also recommend that Fifth Third Bank be required to implement written procedures or maintain other records on the initial evaluations and the continual monitoring of entities with which it has ELT agreements and maintain the records in a central location. We recommend that FSA cease entering into new FFEL participation agreements with Fifth Third Bank for ELT agreements until Fifth Third Bank has implemented corrective action.
In its comments to the draft report, Fifth Third Bank disagreed with our findings and recommendations and commented on the Other Matter section. Fifth Third Bank also provided SLX’s comments on the draft report for our consideration. Fifth Third Bank’s and SLX’s comments are summarized at the end of each finding and the Other Matter section, along with our response to the comments. The entire texts of their comments are included in the report as Enclosures 2 and 3.
BACKGROUND

National banks and other types of entities listed in § 435(d)(1) of the HEA can participate as eligible lenders in the FFEL Program. Eligible lenders may enter into trust arrangements with entities not listed in § 435(d)(1) of the HEA for the purpose of allowing the other entities to originate or purchase student loans. The eligible lender, as the ELT for the other entity, applies and signs for the LID issued by the U.S. Department of Education (Department) and the Department’s Lender/Servicer Organization Participation Agreement.

Section 435(d)(2) through (6) of the HEA specifies additional requirements for eligible lenders. Under § 435(d)(5) of the HEA, a lender may be disqualified from participation if the Department finds that the lender provided certain prohibited inducements. Section 436(b) of the HEA clearly states that a lender that holds a loan made in the lender’s capacity as a trustee is responsible for complying with all statutory and regulatory requirements imposed on any other holder of a loan.

Fifth Third Bank is a national bank that offers a range of banking services and loans, including Federal and private student loans. As an eligible lender, Fifth Third Bank had also entered into ELT agreements with other entities for the origination of Federal student loans. On June 30, 2007, Fifth Third Bank had 15 ELT agreements with other entities under which FFELs were originated or held during the period from July 1, 2006 to June 30, 2007. Between July 1, 2004 and August 30, 2007, over $13 billion in FFEL loans were originated under Fifth Third Bank’s ELT agreements. This amount included Subsidized Stafford, Unsubsidized Stafford, PLUS loans to parents and graduate/professional students, and consolidation loans. Enclosure 1 provides a list of the ELT agreements in effect as of June 30, 2007, associated LIDs, and the entities with related agreements for the funding, originating, servicing, and selling of FFELs.
AUDIT RESULTS

Fifth Third Bank, as the ELT in agreements with other entities, violated the provisions prohibiting inducements specified in § 435(d)(5) of the HEA. Fifth Third Bank and SLX jointly entered into separate ELT agreements with three entities — MSA, PLP, and LSF — that violated the provision in § 435(d)(5)(A) of the HEA prohibiting the offering of inducements to secure borrower applications for FFELs. Our review of Fifth Third Bank’s other ELT agreements disclosed arrangements that also include the offering of inducements, which we discuss in the OTHER MATTER section of the report. Nothing came to our attention to indicate that Fifth Third Bank’s ELT agreements included activities that would violate the other three prohibited practices listed in § 435(d)(5) of the HEA.1

We also found that Fifth Third Bank needs to improve its monitoring of the entities with which it has ELT agreements. Fifth Third Bank did not have written policies and procedures for evaluating the entities and monitoring their activities. It also did not maintain adequate documentation of its evaluation and monitoring efforts.

FINDING NO. 1 – Fifth Third Bank, as an ELT, Violated the Prohibition on Offering Inducements

Fifth Third Bank and SLX violated the prohibition on offering inducements when they entered into ELT agreements with each other and the following other entities: MSA, PLP, and LSF. The Fifth Third Bank’s ELT agreements with SLX/MSA, SLX/PLP, and SLX/LSF violated the inducement prohibition in § 435(d)(5)(A) of the HEA because each agreement specified that SLX (a named party to the trust) will pay a premium to the other entity named in the trust (i.e., MSA, PLP, LSF) for loans originated under the ELT agreement based on the loan principal when the expressed role of the other entity was to secure applications.

Under § 435(d)(5) of the HEA, lenders may be disqualified from participation in the FFEL Program if they offer points, premiums, payments, or other inducements, to any educational institution or individual in order to secure applications for loans. The cited statute states—

The term “eligible lender” does not include any lender that the Secretary determines, after notice and opportunity for a hearing, has after the date of enactment of this paragraph—

(A) 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 . . . .2

---

1 Section 435(d)(5)(B) of the HEA prohibits lenders from conducting unsolicited mailings of student loan applications to students, except to students who have previously received loans from the lender. Section 435(d)(5)(C) prohibits lenders from offering an inducement to a prospective borrower to purchase a policy of insurance or other product. Section 435(d)(5)(D) prohibits lenders from engaging in fraudulent or misleading advertising.

2 The Higher Education Opportunity Act (Public Law 110-315), enacted on August 14, 2008, amended this provision of the HEA. In our review and this report, we applied the provision that was in effect during the audit period.
The Department issued Dear Colleague Letter (DCL) 89-L-129 (February 1989) to provide lenders and guaranty agencies with guidance in complying with the prohibition in § 435(d)(5) of the HEA. The DCL states—

The Department believes these provisions were broadly intended to prohibit the direct or indirect offering or payment of any kind of financial incentive by a lender to any entity or person to secure applications for . . . loans . . . regardless of the form of the incentive or its mode of payment.

The DCL listed the following as an example of a permissible activity between lenders—

A lender purchases a loan made by another lender at a premium. This is not a transaction involving the securing of applicants, but rather the acquisition of loans already made. A purchasing lender may also act as the agent of a selling lender on a loan to be purchased for purposes of originating and disbursing the loan, and purchase the loan at a premium immediately following disbursement. The funds used to make the loan would be deemed to have been advanced to the seller by the purchaser and subsequently repaid from the sale proceeds.

The payments made by SLX under Fifth Third Bank’s ELT agreements with SLX/MSA, SLX/PLP, and SLX/LSF and the related agreements violate the prohibited inducement provisions. As explained in the following section, the activities under the ELT agreements and related agreements are not, in fact, the sale of existing loans between two lenders. Rather, the ELT agreements and related agreements provided for the payment of premiums by SLX to entities (i.e., MSA, PLP, and LSF) to secure loan applications.

**ELT Agreements with SLX/MSA, SLX/PLP, and SLX/LSF Violated the Prohibition on Inducements**

MSA, PLP, and LSF entered into separate trust agreements with SLX and Fifth Third Bank to create trusts in order for Fifth Third Bank, as the ELT, to hold all rights, title, and interest to eligible loans and to transfer ownership of the loans from the trusts to SLX. Each of the ELT agreements contain the same terms. By executing the agreement, MSA, PLP, and LSF agreed that the trusts would not originate or hold any student loan, other than eligible loans to be sold to SLX, under the LID specified in the ELT agreement. The ELT agreement was signed by representatives of Fifth Third Bank, SLX, and the other entity (i.e., MSA, PLP, LSF).

As part of the arrangement, MSA, PLP, and LSF entered into agreements involving SLX, Education Lending Services, Inc, and Xpress Loan Servicing, all of which are part of Education Lending Group, Inc., a wholly owned subsidiary of CIT Group, Inc.
The ELT agreements required MSA, PLP, and LSF to enter into two agreements:

- **Student Loan Forward Commitment Sale/Purchase Agreement.** The agreement provides for the sale of consolidation loans to SLX on the same day that funds are disbursed by the Servicer (Xpress Loan Servicing) to the former loan holders. The agreement requires the seller (i.e., MSA, PLP, LSF) to enter into a Loan and Security Agreement (see below) with Education Lending Services, Inc., which is to provide the funds to pay the holders of the loan being consolidated. SLX is to transmit the “purchase price” for the loans to Education Lending Services. Twice monthly, SLX is to also transmit the “premium” to Education Lending Services. The premium is based on the principal amount of the consolidation loan. Education Lending Services is to retain a portion of the premium for lender loan fees and pay the remaining premium to the seller (i.e., MSA, PLP, LSF). The agreement was signed by four parties: the seller, SLX, Fifth Third Bank as ELT for the seller, and Fifth Third Bank as ELT for SLX.

- **Consolidation Loan Origination and Servicing Agreement.** The agreement states that the lender (i.e., MSA, PLP, LSF) will provide Xpress Loan Servicing with a completed consolidation loan application and Loan Verification Certificates. Xpress Loan Servicing is to pay the prior loan holders, send the disclosure statement to the borrower, and retain the original loan documents. Xpress Loan Servicing is to service the loans and complete all forms and reports required by the Department and the guaranty agency. The agreement contains a schedule for loan origination, servicing, and other miscellaneous fees. The agreement is signed by the lender, Xpress Loan Servicing, and Fifth Third Bank as ELT for the lender.

The other agreements entered into by MSA, PLP, and LSF, but not mentioned in the ELT agreements, were:

- **Loan and Security Agreement.** The agreement provides for the line of credit for financing the consolidation loans. The agreement was signed by four parties: the borrower (i.e., MSA, PLP, LSF), Fifth Third Bank as ELT for the borrower, Education Lending Services, Inc., and Fifth Third Bank as ELT for Education Lending Services, Inc.

- **Administration Agreement.** The agreement provides for various financial, statistical, accounting, and other administrative services, including the distribution of payments to the Xpress Loan Servicing and guarantee agencies. The agreement fee is $100 per year. The agreement was signed by the entity (i.e., MSA, PLP, LSF) and Education Lending Services, Inc.

Under the terms of the ELT agreements and related agreements, MSA, PLP, and LSF are not lenders since the origination of FFELs is restricted to those exclusively funded, serviced, and purchased by SLX and its affiliates. The role of MSA, PLP, and LSF was limited to the securing of loan applications (marketing) and obtaining loan verification certificates.³ Also, an arms-

---

³ Fifth Third Bank applied for and signed for a LID for each of the ELT agreements. With LIDs, MSA, PLP, and LSF obtained user accounts for accessing the National Student Loan Data System (NSLDS). Dear Colleague GEN-05-06 FP-05-04 “Access to and Use of NSLDS Information,” specifically prohibits the use of NSLDS for the marketing of student loans.
length sale of loans did not occur. Fifth Third Bank holds loans in trust under its ELT agreements and SLX is a party to the trust with exclusive rights to the loans. Basically, SLX is transferring its interest in the loans held in one trust (trust established by the ELT agreement with SLX/MSA, SLX/PLP, and SLX/LSF) to another trust to which SLX or an affiliate of SLX is a party. Thus, the example of a lender-to-lender sale of existing loans at a premium (a permissible activity described in DCL 89-L-129) would not apply to Fifth Third Bank’s ELT agreements with SLX/MSA, SLX/PLP, and SLX/LSF.

Based on our interviews with MSA’s President, we concluded that the ELT agreement and related agreements among Fifth Third Bank, SLX, and MSA were created for the purpose of creating a structure to pay a financial incentive to secure loan applications. MSA was a marketer\(^4\) of Federal consolidation loans prior to and after entering into the ELT agreement with Fifth Third Bank and SLX. Prior to the ELT agreement, MSA had a contract to sell consolidation loan applications to SLX at a flat rate (without premium) and, after entering the ELT agreement, MSA continued to sell applications to other lenders at a flat rate. SLX representatives acknowledge that, under the prior contract with MSA, SLX could not pay a premium for applications. According to MSA’s President, SLX told MSA that the ELT arrangement would allow SLX to pay MSA premiums for the loans it purchased. MSA’s President stated that MSA continued to perform its marketing activities and had no additional activities resulting from the ELT agreement. MSA also had no additional costs since, under the terms of the ELT agreement, SLX was to pay Fifth Third Bank a reasonable compensation for services on behalf of MSA. Thus, under the ELT agreement, MSA remained solely a marketer, that is, an entity that secured loan applications for lenders. The scenarios are similar for PLP and LSF since both perform marketing activities and have the same arrangements with SLX and its affiliates.

The following table shows the amount of loans that were originated under the ELT agreements with Fifth Third Bank:

<table>
<thead>
<tr>
<th>Entity</th>
<th>LID</th>
<th>Consolidation Loans</th>
</tr>
</thead>
<tbody>
<tr>
<td>SLX/MSA</td>
<td>834243</td>
<td>$76 million</td>
</tr>
<tr>
<td>SLX/PLP</td>
<td>834196</td>
<td>$2.759 billion</td>
</tr>
<tr>
<td>SLX/LSF</td>
<td>834241</td>
<td>$256 million</td>
</tr>
</tbody>
</table>

(a) The total amount of loans originated under the LID as shown in the National Student Loan Data System (NSLDS) on November 15, 2007. Only consolidation loans were originated under these LIDs.

---

\(^4\) MSA operated a telemarketing call center that contacted individuals with educational loans to solicit their interest in FFEL Consolidation Loans. MSA purchased lists of individuals with existing education loans from credit bureaus.
Fifth Third Bank officials informed us that the ELT agreements with SLX/MSA and SLX/LSF have been terminated. On February 20, 2008, Fifth Third Bank advised the Department and the applicable guaranty agency to terminate the related LIDs.

**Violation of the Prohibition on Offering Inducements**

*Impacts the Federal Guarantee of FFELs and Interest and Special Allowance Payments*

The Federal Government guarantees a portion of each FFEL insured under a program of a State or nonprofit guaranty agency. A lender’s failure to comply with the HEA and other Federal requirements may invalidate the Federal guarantee on FFELs originated or held by the lender. The Department may not pay reinsurance to guaranty agencies on loans that do not have a Federal guarantee. Also, the Department requires a lender to repay interest and special allowance payments received on a loan that was made during a period when the lender was not in compliance with the HEA and other Federal requirements.

**Reinsurance.** The lender submits a claim to the guaranty agency for the outstanding amount of the loan balance, including unpaid interest, when a FFEL borrower defaults on a loan or the lender is otherwise unable to collect the amount owed by the borrower (death, disability, or bankruptcy). The Department has a reinsurance agreement with the guaranty agency to reimburse the guaranty agency for a portion of the lender claims. The conditions that must be met for reinsurance coverage are listed in 34 C.F.R. § 682.406. The condition listed at (a)(12) states that a reinsurance payment can be received only if the lender complied with “all other Federal requirements with respect to the loan.” Thus, failure to comply with the prohibition on offering improper inducements impacts the Federal guarantee of FFELs.

**Interest and Special Allowances.** The Department pays a lender, on behalf of a borrower, a portion of the interest on an eligible subsidized Stafford FFEL and on all or a portion of a qualifying Consolidation FFEL. The Department also pays lenders a special allowance on eligible FFELs. The regulations at 34 C.F.R. § 682.413(a)(1) state that the Department requires a lender to repay interest benefits and special allowances or other compensation received on a loan for periods that the lender failed to comply with requirements set forth in 34 C.F.R. § 682.406(a)(12).

**Recommendations**

We recommend that the Acting Chief Operating Officer for Federal Student Aid—

1.1 Terminate Fifth Third Bank’s participation in the FFEL Program under the ELT agreements with SLX/MSA, SLX/PLP, and SLX/LSF, deactivate the LIDs for those ELT agreements, and notify the guaranty agencies of the terminations.

1.2 Take appropriate action to address Fifth Third Bank’s violation of the inducement provision. The Department should consider taking one or more of the following actions: assessing a fine; initiating a limitation, suspension, or termination proceeding under 34 C.F.R. § 682, Subpart G; requiring reimbursement of amounts paid for default claims, interest and special allowances, and any other benefits on FFELs originated under the ELT agreements with SLX/MSA, SLX/PLP, and SLX/LSF; or terminating the Federal...
reinsurance on all FFELs originated under those ELT agreements. As of November 15, 2007, over $3 billion of FFELs had been originated under the ELT agreements.

Fifth Third Bank Comments

Fifth Third Bank disagreed with the finding and recommendations. Fifth Third Bank stated the payments at issue were proper because they were for the sale of loans, and not for the marketing of loan applications. Fifth Third Bank made the following assertions:

- The finding is indistinguishable from the prior Department’s administrative enforcement proceeding that was overturned by the U.S. District Court for the District of Columbia in Student Loan Marketing Ass’n v. Riley, 112 F. Supp.2d 38 (D.D.C. 2000) (Scholl College case). The form of the agreements between SLX and the other entities (i.e., MSA, PLP, and LSF), like the form of the agreements in the Scholl College case, were typical of transactions on the secondary market. Similar to the Department’s argument that was rejected by the court in the Scholl College case, the finding disregarded the form of the transactions to determine that the combination of the agreements suggest that SLX was the originating lender instead of MSA, PLP, and LSF. The aspects of the transactions that lead the OIG to disregard the form of the transactions were authorized by the HEA or were otherwise permissible. Federal regulations authorize a lender to contract or otherwise delegate performance of its functions under the FFEL Program to a servicing agency or other party.

- The inclusion of SLX as a party to the ELT agreements neither created a beneficial interest of SLX in the loans residing in the trusts, nor diminished the full and exclusive beneficial ownership interest of MSA, PLP and LSF in the loans residing in the respective trusts. SLX’s duties under the ELT agreements were largely ministerial, and its obligations were basically to pay, on behalf of MSA, PLP, and LSF, the costs of commencing and maintaining the ELT agreements.

- MSA, PLP, and LSF gained no more from the transactions with SLX than would any other lender. Consequently, the payments made by SLX did not provide any unreasonable incentive to take certain actions and, therefore, cannot be said to rise to the level of an improper inducement.

In addition, Fifth Third Bank stated the Department has always interpreted the prohibition against inducements to permit this type of sale of loans between lenders; thus, the Department cannot change its interpretation of the inducement prohibition without prior notice. Fifth Third Bank also stated that the payments for Federal consolidation loans did not involve any of the risks targeted by the HEA’s prohibition against inducements. Lastly, Fifth Third Bank stated the payments at issue were not prohibited because the payments were made to neither an “educational institution” nor an “individual,” as required by the plain language of the HEA.

In regards to the recommendations, Fifth Third Bank considered Recommendation 1.1 to be moot since Fifth Third Bank had terminated the three ELT agreements at issue in the finding.
Fifth Third Bank stated that Recommendation 1.2 (as stated in the draft report)\(^5\) was disproportionate to the alleged offenses and would be more appropriately addressed through the Department’s informal compliance procedures, imposition of a fine, or the regulatory provisions governing limitation, suspension, and termination proceedings. Fifth Third Bank also stated Recommendation 1.2 was adverse to the best interests of market participants and borrowers.

**SLX Comments**

SLX also disagreed with the finding and recommendations. SLX made several comments that were similar to those provided by Fifth Third Bank. In regards to the Scholl College case, SLX added that ED had repeatedly confirmed in the course of those proceedings that, had the arrangement in that case involved a non-school lender, it would have been permissible. In regards to SLX’s duties under the ELT agreement, SLX stated ED has recognized and condoned the practice of a loan purchaser paying fees due on purchased loans on the seller’s behalf and cited 34 CFR § 682.305(a)(4)(i) as support for its statement. SLX also noted that OIG did not conclude that the form of the arrangement involving the Alder School of Professional Psychology should be disregarded even though its trust agreement calls for SLX to compensate Fifth Third Bank for the services it renders as trustee for Alder School of Professional Psychology on loans sold to SLX.

SLX made the following additional assertions in its comments:

- MSA, PLP, and LSF accepted substantial obligations not required of mere marketers. They borrowed money to fund their loans and obligated themselves to repurchase any loan that becomes unreinsured due to a violation that occurs prior to the sale of the loan to SLX. SLX stated that one of the entities had repurchased in excess of $1 million in loans sold to SLX under their Forward Purchase Agreement that turned out to be unreinsured when sold.

- Many lenders in the FFEL Program started as marketers and first embarked on that role via relationships with established industry participants, such as SLX. The finding’s proposed ban on marketing entities becoming lenders via such relationships would effectively foreclose program participation to many lenders that have provided vigorous competition for Sallie Mae and large bank lenders in the program, to the benefit of borrowers and the Federal Government.

- Marketing does not constitute securing loan applicants, regardless of how the marketer is compensated. The term “secure” in § 435(d)(5)(A) of the HEA prohibits lenders from paying schools to steer borrowers to the lender, regardless of the basis of payment, while at the same time permitting compensated marketing activities by non-school affiliated entities. The term “secure” as used in the HEA permits marketing where the lender or marketing agent must rely solely on the merits of the lender’s loan products and service, but to prohibit paid referrals (i.e., paying someone who likely has the trust of the student to influence the student’s borrowing decisions).

---

\(^5\) Recommendation 1.2 in the draft report recommended the termination of the Federal reinsurance on all FFELs originated under the ELT agreements and reimbursement of amounts paid by the Department for default claims, interest, and special allowance. As we explain in the OIG Response section of this finding, we modified the recommendation for the final report.
DCL 89-L-129 took this approach when it recognized that generalized marketing did not constitute securing applicants, and therefore could be compensated as the parties saw fit, while at the same time prohibited referral fees to compensate lenders who, by exploiting existing relationships with potential FFELP borrowers, were able to steer them to another lender for a FFELP loan. Even if the transactions at issue could be re-characterized as proposed in the finding, the payments would merely be compensation for marketing by a non-school affiliated entity with no special position of trust or influence with prospective borrowers, and not for referrals.

OIG Response

We modified Recommendation 1.2 to acknowledge the various actions that the Department could take to address Fifth Third Bank’s violation of the inducement provision. The language of the HEA supports termination of the Federal reinsurance on all FFELs originated under the ELT agreements. However, the Department may determine that other action(s) may be more appropriate to mitigate the potential harm to borrowers. We did not make other changes to the finding in response to the comments provided by Fifth Third Bank and SLX.

Scholl College Case. The decision in the Scholl College case was limited to the particular facts presented. While aspects of the case are similar to the arrangements under the ELT agreements, there are critical differences. The Scholl College case involved transactions between two discrete and independent eligible lenders – Dr. William M. Scholl College of Podiatric Medicine and Student Loan Marketing Association. SLX, MSA, PLP, and LSF are not eligible lenders. Also, as we noted in the finding, SLX was a party to the trusts created by the ELT agreements at issue in our finding and those agreements obligated MSA, PLP, and LSF to sell all loans from the ELT arrangements with Fifth Third Bank to SLX. The transactions that resulted in the transfer of loans from the LID for the ELT arrangements that Fifth Third Bank and SLX had with MSA, PLP, and LSF to SLX did not represent an arms length sale of loans between two discrete eligible lenders. In the Scholl College case, Scholl College actually borrowed funds from and paid interest to the Student Loan Marketing Association to fund loans and held the loans for a period of time before the loans were sold to Student Loan Marketing Association. However, uncertainty exists as to whether MSA, PLP, and LSF actually borrowed funds under the Loan and Security Agreements. Under the terms of the agreements, MSA, PLP, and LSF were to provide written “Borrowing Notices” for loans drawn on the lines of credit. SLX was unable to locate any such notices. Further, under the arrangements, MSA, PLP and LSF would owe interest to SLX only if the various transactions processed by SLX and its affiliates were not completed on the same day that MSA, PLP, and LSF submitted completed applications to SLX. SLX is not aware of any instances where it earned interest from MSA, PLP, or LSF due to the transactions not being completed within the same day the eligible loans were sold to SLX.

Beneficial Interest to SLX. We acknowledge that under the terms of the ELT agreements with Fifth Third Bank, MSA, PLP, and LSF held a beneficial interest in the loans originated and briefly held under those trust arrangements. However, as a party to those same ELT agreements, SLX had a direct, financial interest in the loans originated and held in the trusts. Those agreements obligated MSA, PLP, and LSF to transfer all such loans to SLX. In addition, SLX is a subsidiary of CIT Group, Inc., and CIT Group, Inc. controlled all transactions related to the
loans through the related agreements that SLX and its other subsidiaries had with MSA, PLP, and LSF.

Inducements to MSA, PLP, and LSF. The Student Loan Forward Commitment Sale/Purchase Agreements, which MSA, PLP, and LSF were required to enter into with SLX under the terms of the ELT agreements, created an inducement for MSA, PLP, and LSF to provide applications to Xpress Loan Servicing for origination of loans under the LIDs for the ELT agreements. Under the Sale/Purchase agreements, SLX paid higher compensation to MSA, PLP, and LSF for completed consolidation loan applications obtained from FFEL borrowers that had higher loan balances. The compensation escalated substantially as loan balances increased. For example, the agreement with PLP shows the following principals and net premiums:

<table>
<thead>
<tr>
<th>Principals</th>
<th>Net Premium</th>
</tr>
</thead>
<tbody>
<tr>
<td>$0</td>
<td>0%</td>
</tr>
<tr>
<td>$10,000</td>
<td>1.60%</td>
</tr>
<tr>
<td>$15,000</td>
<td>2.65%</td>
</tr>
<tr>
<td>$20,000</td>
<td>3.00%</td>
</tr>
<tr>
<td>$30,000</td>
<td>3.65%</td>
</tr>
<tr>
<td>$40,000</td>
<td>4.35%</td>
</tr>
<tr>
<td>$50,000</td>
<td>4.45%</td>
</tr>
<tr>
<td>$65,000 +</td>
<td>4.85%</td>
</tr>
</tbody>
</table>

Thus, MSA, PLP, and LSF received prohibited inducements for securing loan applications. Other than securing the loan applications, these entities provide no additional services for the higher fees. SLX also benefited from the market advantage it had by offering the higher compensation to obtain applications for consolidation loans with higher balances.

Department’s Interpretation of Prohibition on Inducements. The OIG recognizes that the Department has allowed the sale of existing loans between lenders, including the acquisition of a loan at a premium. (See Dear Colleague Letter 89-L-129 (February 1989), page 3, example 1, under permissible activities.) However, the transactions described in this finding did not involve the sale of existing loans between eligible lenders. In contrast to the permissible activity outlined in the DCL, the transactions here were the sale of completed consolidation loan applications between entities participating in the FFEL program through the existence of ELT agreements with Fifth Third Bank. The transactions did not involve eligible lenders or loans that were already made. Payments to secure loan applications is specifically prohibited by § 435(d)(5)(A) of the HEA, and the HEA does not provide an exception for consolidation loan applications.

Educational Institution/Individual. Fifth Third Bank’s literal argument that the HEA prohibits inducements only if made to an “educational institution” or an “individual” has been rejected by the Department. In fact, the same DCL 89-L-129 that Fifth Third Bank relies upon in its attempts to justify its transactions under the example of permissible activities between lenders, includes examples (i.e., page 2, examples 3, 4 and 8) of prohibited inducements involving payments to organizations other than institutions or to an individual as a person. Also, in response to public comments contained in the preamble to the November 1, 2007, Final Regulations (72 Fed. Reg. 61960, 61978-61979), the Secretary addressed an argument to remove the reference in the regulation to “any individual” and replace it with “any employee of a school or a school-affiliated organization” to clarify the group to which the prohibitions apply. The Secretary’s position was stated as follows:
The Secretary disagrees that the reference to “individuals” should be struck from paragraph (5)(i)(A)(2) of the definition of lender in § 682.200(b). Section 435(d)(5) of the HEA effectively defines an improper inducement as a payment or other inducements “to any educational institution or individual” to secure loan applications. The Secretary has never interpreted the reference to “individuals” as limited to employees of a school or school-affiliated organization.

The Department’s published guidance on inducements, and Fifth Third Bank’s own references to selected sections of Departmental guidance, when read in their entirety, contradict Fifth Third Bank’s plain language reading of the HEA.

Fifth Third’s ELT Agreement with Alder School of Professional Psychology. We did not include this ELT agreement in the finding because the agreement was solely between Fifth Third Bank and Alder School of Professional Psychology. SLX was not a named party to the trust and did not sign the ELT agreement. As mentioned in the OTHER MATTER section of the report, we will be referring other Fifth Third Bank’s ELT agreements that included the offering of inducements to the Department for further review. Fifth Third Bank’s ELT agreement with Alder School of Professional Psychology is one of the agreements that we will be providing to the Department.

MSA, PLP, and LSF Obligations Under the ELT and Related Agreement. The Student Loan Forward Commitment Sale/Purchase Agreements included provisions requiring MSA, PLP, or LSF to purchase loans upon the request of SLX if any representations or warranties made prove to have been materially incorrect or the Department or guaranty agency refuses to honor a claim filed with respect to a loan as a consequence of any circumstance, event, or omission that was directly due to acts or omissions of MSA, PLP, or LSF. SLX did not explain how this provision was more onerous than those placed on other marketers. In any event, the argument is pointless. Even if MSA, PLP, and LSF had assumed obligations beyond those placed on other entities that provide marketing services, such obligations are irrelevant in determining whether SLX can pay inducements to MSA, PLP, and LSF.

Compensation for Permitted Marketing Activities. SLX attempted to draw a distinction between allowable general marketing compensation and the prohibited compensation for securing of loan applications. SLX also characterized compensation for general marketing (or advertising) by non-school affiliate entities with no position of trust or influence with the borrower, as being the agreed-upon compensation by entities. OIG’s position is that the structure of the agreements between SLX and the other entities (e.g., MSA) did not provide for general marketing or advertising. Compensation was based solely and explicitly on the ability to secure and provide those completed applications. MSA purchased leads from credit bureaus on borrowers with FFEL loans, solely for the intended purpose of (through direct contact with the borrower) influencing the borrower to complete a consolidation loan application. Upon completion of the loan application, MSA provided the secured loan application for a fee. MSA was not compensated for anything other than secured completed applications. Payments to secure loan applications is specifically prohibited by § 435(d)(5)(A) of the HEA. The HEA does not provide any exception for non-school affiliated entities with no position of trust or influence with prospective borrowers.
FINDING NO. 2 – Fifth Third Bank’s Policies and Procedures for Monitoring its ELT Agreements Need To Be Improved

Fifth Third Bank’s Vice President for the Asset Securitization Department is responsible for the evaluation of entities for potential ELT agreements and the monitoring of existing ELT agreements. Fifth Third Bank did not have written policies and procedures for these activities (including policies and procedures to ensure that the agreements do not include or result in payment of prohibited inducements) and did not maintain adequate documentation of such activities. Thus, Fifth Third Bank lacked the internal controls to ensure that evaluation and monitoring activities were thorough and consistently performed.

Section 436 of the HEA establishes a lender’s responsibility when lender functions are delegated to other entities. The cited statute states—

(a) IN GENERAL.— An eligible lender or guaranty agency that contracts with another entity to perform any of the lender’s or agency’s functions under this title, or otherwise delegates the performance of such functions to such other entity—

(1) shall not be relieved of the lender’s or agency’s duty to comply with the requirements of this title; and

(2) shall monitor the activities of such other entity for compliance with such requirements.

(b) SPECIAL RULE.— A lender that holds a loan made under part B in the lender’s capacity as a trustee is responsible for complying with all statutory and regulatory requirements imposed on any other holder of a loan made under this part.

As an eligible lender, Fifth Third Bank is required to comply with all requirements applicable to lenders participating in the FFEL loan program, including the requirement in 34 C.F.R. § 682.414(a)(4)(ii)(L) to maintain records that are necessary to document the validity of claims and the accuracy of reports. In its capacity as an ELT, Fifth Third Bank relies on the entities with which it has ELT agreements and the entities involved in the related agreements (i.e., loan servicers, etc.) to perform lender functions in compliance with all Federal requirements applicable to lenders. Thus, under the records requirements specified in 34 C.F.R. § 682.414(a)(4)(ii)(L), Fifth Third Bank needs to maintain records of its activities for ensuring that valid claims and accurate reports are submitted to the Department and guaranty agencies for loans originated or held under the ELT agreements.

The U.S. Department of the Treasury, Office of the Comptroller of the Currency oversees the execution of laws relating to national banks and promulgates rules and regulations governing the operations of national banks. As a national bank, Fifth Third Bank is subject to the Safety and Soundness Standards set forth by the Comptroller in 12 C.F.R. Part 30. The Comptroller recognized the importance of internal controls over banking operations in Appendix A to Part 30, which provides the operational and managerial standards for national banks. The standards include—
A. Internal controls and information systems. An institution should have internal controls and information systems that are appropriate to the size of the institution and the nature, scope and risk of its activities and that provide for:

1. An organizational structure that establishes clear lines of authority and responsibility for monitoring adherence to established policies;
2. Effective risk assessment;
3. Timely and accurate financial, operational, and regulatory reports;
4. Adequate procedures to safeguard and manage assets; and
5. Compliance with applicable laws and regulations.

The U.S. Treasury regulations were not issued to directly address administration of the HEA, Title IV programs; and the U.S. Treasury, not the Department, is the Federal agency responsible for enforcing the provisions contained in those issuances. However, the U.S. Treasury regulations provide a standard of internal control that Federal agencies may reasonably expect banks to meet when participating in their programs.

The Vice President for the Asset Securitization Department advised us that, as part of Fifth Third Bank’s risk management, he evaluates the entities and their proposed arrangements prior to entering into an ELT agreement and, after entering into an ELT agreement, conducts continual monitoring to verify that the entities remain in good standing in the student loan industry and maintain their financial standing. In response to our inquiry, Fifth Third Bank prepared a document to describe its evaluation and monitoring procedures.

The document listed six elements that the bank evaluates to determine whether it will enter into an ELT agreement with an entity:

- Industry experience and management;
- Student loan origination and servicing arrangements;
- Funding commitments;
- Student loan sale and purchase commitments;
- Student loan processes and systems; and
- Financial strength.

To evaluate the above elements, the Vice President informed us that he, one of the two other bank officials in the Asset Securitization Department, or a manager from a bank branch office located near the entity, conducts a site visit to interview the prospective entity to assess its expertise in the student loan industry and business practices. A site visit is not conducted if the branch manager has an on-going business relationship with the entity. Fifth Third Bank also reviews the entity’s financial statements. The Vice President stated that the entity’s loan servicer and the purchaser of the entities’ loans are significant factors in Fifth Third Bank’s decision to enter into an ELT agreement with an entity.
According to the prepared document and explanations provided by the Vice President, Fifth Third Bank performs the following on-going monitoring activities:

- Reviews monthly loan activity for entities with low loan volume;
- Reviews annual financial statements;
- Reviews the bill of sale for all secondary loan sales;
- Maintains continual contact with relationship manager or other Fifth Third Bank managers that conduct due diligence for their services with the entity;
- Establishes ongoing business relationships with lenders and companies in the industry;
- Studies the publications for the industry;
- Reviews guaranty agency reports on loan servicers;
- Reviews annual marketing and origination process reviews for SLX agreements; and
- Attends student loan conferences.

Fifth Third Bank’s Vice President stated that the guaranty agency reports are reviewed to ensure that the lenders and servicers are processing loans in accordance with Federal laws and regulations. However, Fifth Third Bank did not have a process to ensure that it received all pertinent reports from the guaranty agencies. Also, the above activities do not include a review of the annual independent public accountant audit reports that are required for lenders and loan servicers that perform activities for loans guaranteed under the FFEL Program.

The Vice President maintained some documents related to initial assessments and ongoing monitoring, but could not identify the documents related to each ELT agreement. Fifth Third Bank provided some examples of monthly loan activity reports, financial statements, and guaranty reports. Correspondence was either not retained or located only after searches of files in other departments.

Without sufficient written procedures and complete documentation of evaluations, there is a lack of assurance that Fifth Third Bank is adequately evaluating entities and their relationships with third parties in a thorough and consistent manner. Also, there is a lack of assurance that Fifth Third Bank is performing sufficient monitoring of entities with which it has ELT agreements to ensure that the entities adhered to applicable requirements of the FFEL Program, including the prohibition on offering inducements to secure loan applications. Until Fifth Third Bank can demonstrate that it has written procedures or other records that provide a consistent and effective means for ensuring the other entities’ compliance with applicable FFEL program requirements, the Department lacks assurance that Fifth Third Bank is meeting its responsibility under § 436(b) of the HEA or can confirm the validity of claims or the accuracy of reports submitted to the Department and guaranty agencies.
Recommendations

We recommend that the Acting Chief Operating Officer for Federal Student Aid—

2.1 Require Fifth Third Bank to implement written procedures or maintain other records that document thorough and consistent initial evaluations of entities for potential ELT agreements and the continual monitoring of entities with which it has ELT agreements to ensure compliance with all FFEL Program requirements, including the prohibition on offering inducements to secure loan applications.

2.2 Require Fifth Third Bank to maintain, in a central location, the records related to its initial assessment and monitoring of each ELT agreement.

2.3 Cease issuing new LIDs to Fifth Third Bank for ELT agreements until the corrective actions under Recommendations 2.1 and 2.2 have been completed.

Fifth Third Bank Comments

Fifth Third Bank disagreed with the finding and recommendations. Fifth Third Bank stated that written policies and procedures for (1) evaluation of entities for potential ELT agreements and (2) monitoring of existing ELT agreements do not relate to the requirement that lenders document the validity of claims and accuracy of reports. Fifth Third Bank stated that such documentation tasks would likely be performed by the ELT’s lender partners (i.e., entities with which the ELT has trust agreements). Fifth Third Bank acknowledged that an ELT would be responsible for the lender partner’s compliance with documentation requirements. However, Fifth Third Bank stated that an ELT cannot be cited for failing to maintain records documenting the validity of claims and accuracy of reports on the basis of not having written policies and procedures for the evaluation of potential lender partners and monitoring of those lenders. Fifth Third Bank claimed that the finding did not link the two concepts or cite legal authority to support the linkage.

Fifth Third Bank stated the ED OIG lacked legal authority to make a finding on the basis of the Treasury Department standards and handbook cited in the finding. Fifth Third Bank acknowledged that, if ED OIG had legal authority, the Treasury Department standards on “[e]ffective risk management” and “[a]dequate procedures to safeguard and manage assets” were important requirements and the requirements most relevant to its role as an ELT. However, Fifth Third Bank asserted that the shortfalls noted in the finding were minor and not sufficient to support the conclusion that “[w]ithout sufficient written procedures and complete documentation of evaluations, there is a lack of assurance that Fifth Third Bank is adequately evaluating entities and their relationships with third parties in a thorough and consistent manner.”

Fifth Third Bank stated the recommendations were unnecessary because Fifth Third Bank already uses the recommended procedures and centrally maintains its records. Fifth Third Bank also stated that whether Fifth Third Bank’s procedures should be written and whether its records

6 References to the Comptroller’s Handbook on Internal Controls were not included in the final report. The Handbook, which was issued by the Comptroller of the Currency Administrator of National Banks, contains policies and procedures for the examination of the commercial activities of national banks.
are adequately maintained are moot points since Fifth Third Bank has terminated its ELT agreements with the entities in Finding 1, is transitioning out of the business of serving as an ELT, and does not intend to enter into new ELT agreements.

SLX Comments

SLX did not provide comments on Finding No. 2.

OIG Response

Fifth Third Bank acknowledged its responsibility as an ELT to assure its contractual partners’ compliance with statutory and regulatory requirements. Fifth Third Bank also did not dispute its obligation to monitor compliance, or address our finding that it did not maintain adequate documentation of such monitoring. Fifth Third Bank instead asserted that written policies and procedures for its compliance activities are not required under 34 C.F.R. § 682.414(a)(4)(ii)(L). To clarify, we did not cite Fifth Third Bank just for a lack of written policies and procedures, which is one form of record documenting its internal controls over its contractual partners. Rather, we concluded that "under the records requirements specified in 34 C.F.R. § 682.414(a)(4)(ii)(L), Fifth Third Bank needs to maintain records of its activities for ensuring valid claims and accurate reports are submitted to the Department and guaranty agencies for loans originated and held under the ELT agreements." In the absence of such records, Fifth Third Bank would have to maintain direct records of the validity of claims and accuracy of reports submitted by the entities participating in its ELT arrangements. Our finding and recommendation acknowledged that written procedures or other records could be used to meet its obligations.

We cited the U.S. Treasury regulations to highlight that a national bank, in addition to meeting HEA requirements for eligible lenders, would also be expected to maintain written procedures for internal control. We added language in the finding to acknowledge that the U.S. Treasury is responsible for enforcing its regulations. We did not change our recommendations. While Fifth Third Bank serves as an ELT, it needs to continue monitoring those entities involved in the ELT arrangements. Written procedures and complete documentation would provide assurance that Fifth Third Bank is performing its monitoring in a thorough and consistent manner. As we noted in the finding, our review found that documents related to Fifth Third Bank’s assessments and ongoing monitoring had not been maintained in an organized manner or central location.
OTHER MATTER

Our review of Fifth Third Bank’s other ELT agreements also disclosed arrangements that included the offering of an inducement. However, the ELT agreements differed structurally from the ELT agreements that Fifth Third Bank and SLX had with MSA, PLP, and LSF. Fifth Third Bank’s ELT agreements with the other entities did not name a third party, such as SLX, in the ELT agreement. Nevertheless, the related agreements that these entities had with third parties created scenarios in which the only loans originated under the ELT agreements were those funded, serviced, and purchased under the agreements and the role of the entity named in the ELT was limited to the securing of loan applications. The related agreements included provisions for the entities to receive a premium based on the loan balance.

The ELT and related agreements, taken together, appear to violate the prohibition on improper inducements, which the Department states in DCL 89-L-129 was “intended to prohibit the direct or indirect offering or payment of any kind of financial incentive by a lender to any entity or person to secure applications for . . . loans . . . regardless of the form of the incentive or its mode of payment.” However, the arrangements were also similar in some respects to an example of a permissible practice described in DCL 89-L-129 and to an arrangement that was the subject of a previous enforcement proceeding undertaken by the Department. Thus, we plan to refer these ELT agreements to the Department for determination of whether the arrangements violated the prohibition on inducements during the period when loans were originated under the ELT agreements.7

Fifth Third Bank Comments

Fifth Third Bank stated that this section of the report revealed that the only problem with the transactions between SLX and MSA, PLP, and LSF is that SLX was a party to the ELT agreement between Fifth Third Bank and those entities. Fifth Third Bank stated the OIG conceded that, without that one fact, the 1989 Dear Colleague Letter and the Scholl College case would preclude a finding of noncompliance. Fifth Third Bank asked that the Other Matter section be omitted from the final audit report.

SLX Comments

SLX stated that its comments on Finding No. 1 were also applicable to the ELT agreements questioned in this section of the report.

OIG Response

No changes were made. Fifth Third Bank is correct that we acknowledged in this section that the significant difference between the ELT agreements cited in Finding No. 1 and Fifth Third Bank’s other ELT agreements was that the other entities did not name a third party, such as SLX, in the ELT agreement. As we noted in Finding No. 1, this factor was significant in determining whether the permissible activity described in DCL 89-L-129 applied to the ELT agreement and related agreements. We concluded that further review by the Department was warranted to determine whether these other ELT agreements violated the prohibition on inducements.

---

7 The Department advised us in February 2008 that the LID for one of the ELTs in question had been terminated. In December 2008, the Department advised us that the LIDS for the other ELTs had also been terminated.
OBJECTIVES, SCOPE, AND METHODOLOGY

The purpose of the audit was to determine whether Fifth Third Bank, as the ELT in agreements with other entities, adhered to the prohibitions on inducements specified in § 435(d)(5) of the HEA, and assess Fifth Third Bank’s monitoring activities for ensuring that entities, with which it has ELT agreements, have adhered to applicable requirements of the FFEL Program. Our review covered Fifth Third Bank’s ELT agreements with other entities that originated or held FFELs under the associated LIDs from July 1, 2006 to June 30, 2007.

To accomplish our objectives, we gained an understanding of pertinent provisions of the HEA of 1965, as amended, Federal regulations, and Dear Colleague Letters issued by the Department. We interviewed Department staff with gate keeping and oversight responsibilities over lenders and reviewed a U.S. Government Accountability Office report to gain an understanding of ELT arrangements.

To identify Fifth Third Bank’s ELT agreements, we analyzed data from NSLDS and obtained additional information by interviewing Fifth Third Bank’s Vice President for the Asset Securitization Department and officials from various other entities. We also used NSLDS to confirm that student loans under the FFEL Program were not being originated by dissolved ELTs or ELTs that were never activated. Our analysis of the Fifth Third Bank’s ELT agreements and related agreements and data from NSLDS identified 15 ELT agreements with other entities that originated or held FFELs from July 1, 2006 to June 30, 2007. We also used NSLDS to obtain information on the amount of loans originated and held under each LID.

We reviewed Fifth Third Bank’s ELT agreements with the 15 entities. When applicable, we obtained and reviewed the related agreements for the financing, servicing, and purchasing of loans originated under the ELT agreement, except we did not review the related agreements for the ELT agreement with SLX, Business Financial Solutions, Inc, and Student Lending Works, Inc. (See Attachment 1 for explanation.)

We interviewed officials from Fifth Third Bank to gain an understanding of its policies and procedures for evaluating the entities that entered into the ELT agreements and the other companies involved in the ELT arrangements. We reviewed Fifth Third Bank’s copies of servicer audits performed by guaranty agencies, and the monthly loan activity reports and financial statements of entities involved in the ELT arrangement. Our on-site review of documentation used for evaluating the entities that entered into the ELT agreements was limited, as Fifth Third Bank did not maintain centralized files for ELTs or retain related correspondence. We also reviewed the list of Fifth Third Bank’s internal audits and its written procedures for the commercial credit approval process.

We performed our fieldwork at Fifth Third Bank’s offices in Cincinnati, Ohio. An exit conference was held with Fifth Third Bank on February 8, 2008. We performed our audit in accordance with generally accepted government auditing standards appropriate to the scope of the review described above.
ENCLOSURE 1: Fifth Third Bank’s ELT Agreements as of June 30, 2007

<table>
<thead>
<tr>
<th>Entities That Signed the ELT Agreement (In addition to Fifth Third Bank as Eligible Lender Trustee)</th>
<th>LIDs</th>
<th>Other Entities Named in the ELT Agreement</th>
<th>Additional Entities That Signed Related Agreements</th>
</tr>
</thead>
<tbody>
<tr>
<td>Student Loan Xpress, Inc. (CIT Group, Inc.) (Includes LID from former ELT agreement with Education Lending Services, Inc.)</td>
<td>833860 833890 833908 834011 834160</td>
<td>ELT refers to “certain affiliates” of SLX, but does not name the specific entities.</td>
<td>Not reviewed. OIG review was limited to the information contained in the current and prior ELT agreements between Fifth Third Bank and SLX.</td>
</tr>
<tr>
<td>Education Funding Capital Trust – II (CIT Group, Inc.)</td>
<td>834042 (Agreements have same LID)</td>
<td>None</td>
<td>Not applicable. FFELs were not originated under this LID. FFELs transferred to this LID are held in the trust as security for funds obtained from investors.</td>
</tr>
<tr>
<td>Education Funding Capital Trust – III (CIT Group, Inc.)</td>
<td>None</td>
<td>None</td>
<td></td>
</tr>
<tr>
<td>Education Funding Capital Trust – IV (CIT Group, Inc.)</td>
<td>None</td>
<td>None</td>
<td></td>
</tr>
<tr>
<td>Business Financial Solutions, Inc., dba Academic Financial Services;</td>
<td>834179 (See Note)</td>
<td>None</td>
<td>Not reviewed. Fifth Third Bank notified FSA on November 1, 2007 that the trust was transferred to U.S. Bank. The Department informed us that the transfer did not take place.</td>
</tr>
<tr>
<td>Student Loan Xpress, Inc. and Pacific Loan Processors</td>
<td>834196 (See Note)</td>
<td>Education Loan Servicing Corporation (CIT Group, Inc.)</td>
<td>Education Lending Services, Inc. (Loan and Security Agreement) Education Loan Servicing Corporation (Consolidation Loan Origination and Servicing Agreement) Student Loan Xpress, Inc. (Student Loan Forward Commitment Sale/Purchase Agreement)</td>
</tr>
<tr>
<td>FinanSure Student Loans, LLC</td>
<td>834204 (The two ELT agreements have the same LID) (See Note)</td>
<td>None</td>
<td>Sallie Mae, Inc. (Revolving Financing Agreement) Sallie Mae, Inc. and SLM Education Credit Finance Corporation (Contract for Sallie Mae, Inc. to originate and service consolidation loans and SLM Education Credit Finance Corporation to purchase consolidation loans) GCO Education Loan Funding Corp (Contract for GCO to purchase loans from FinanSure) Ed Financial Services, LLC (Servicing Agreement) Great Lakes Educational Loan Services, Inc. (Student Loan Origination and Servicing Agreement) ACS Education Services, Inc. (Federal FFEL Servicing Agreement with FinanSure Student Loans former name The Graduate Loan Center)</td>
</tr>
<tr>
<td>FinanSure Student Loan Warehouse Funding I, LLC</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Entities That Signed the ELT Agreement (In addition to Fifth Third Bank as Eligible Lender Trustee)</td>
<td>LIDs</td>
<td>Other Entities Named in the ELT Agreement</td>
<td>Additional Entities That Signed Related Agreements Obtained During Our Review</td>
</tr>
<tr>
<td>------------------------------------------------------------------------------------------------</td>
<td>---------------</td>
<td>----------------------------------------------------------------------------------------------------------</td>
<td>------------------------------------------------------------------------------------------------------------------------------------------------</td>
</tr>
<tr>
<td>Student Loan Xpress, Inc. (CIT Group, Inc.) and Law School Financial, Inc.</td>
<td>834241 (See Note)</td>
<td>Education Loan Servicing Corporation (CIT Group, Inc.)</td>
<td>Education Lending Services, Inc. (Loan and Security Agreement) Education Loan Servicing Corporation (Consolidation Loan Origination and Servicing Agreement) Student Loan Xpress, Inc. ((Student Loan Forward Commitment Sale/Purchase Agreement)</td>
</tr>
<tr>
<td>Student Loan Xpress, Inc. (CIT Group, Inc.) and MSA Solutions, Inc.</td>
<td>834243 (See Note)</td>
<td>Education Loan Servicing Corporation (CIT Group, Inc.)</td>
<td>Education Lending Services, Inc. (Loan and Security Agreement and Administration Agreement) Education Loan Servicing Corporation (Consolidation Loan Origination and Servicing Agreement) Student Loan Xpress, Inc. ((Student Loan Forward Commitment Sale/Purchase Agreement)</td>
</tr>
<tr>
<td>Student Lending Works, Inc.</td>
<td>834254 (See Note)</td>
<td>None</td>
<td>Not reviewed. Student Lending Works is the single nonprofit private student loan lender designated by the State of Ohio (LID 834225).</td>
</tr>
<tr>
<td>Erie Processing Corporation</td>
<td>834311 (See Note)</td>
<td>None</td>
<td>Sallie Mae, Inc. (Revolving Financing Agreement) Sallie Mae Servicing (Loan Origination and Management Services Agreement) SLM Education Credit Finance Corporation (Master Loan Sale Terms)</td>
</tr>
<tr>
<td>Nova Southeastern University, Inc.</td>
<td>834317 (See Note)</td>
<td>None</td>
<td>Sallie Mae, Inc. (Revolving Financing Agreement) Sallie Mae, Inc. and SLM Education Credit Finance Corporation (Contract for Sallie Mae, Inc. to originate and service loans and SLM Education Credit Finance Corporation to purchase the loans)</td>
</tr>
<tr>
<td>Logan College of Chiropractic</td>
<td>834319 (See Note)</td>
<td>None</td>
<td>Sallie Mae, Inc. (Revolving Financing Agreement) Sallie Mae, Inc. and SLM Education Credit Finance Corporation (Contract for Sallie Mae, Inc. to originate and service loans and SLM Education Credit Finance Corporation to purchase the loans)</td>
</tr>
<tr>
<td>Alder School of Professional Psychology, Inc.</td>
<td>834338 (See Note)</td>
<td>Student Loan Xpress, Inc. (CIT Group, Inc.) [Only mentioned in Compensation section. Provides that SLX will compensate Fifth Third Bank for services rendered with respect to loans sold to SLX]</td>
<td>Education Lending Services, Inc (Loan and Security Agreement) Great Lakes Educational Loan Services, Inc (Student Loan Origination and Servicing Agreement) Student Loan Xpress, Inc. (Student Loan Forward Commitment Sale/Purchase Agreement)</td>
</tr>
</tbody>
</table>

**Note:** In its response to the draft report, Fifth Third Bank stated that it was transitioning out of the business of serving as an ELT. Department staff confirmed that the lender identification numbers for these ELT agreements have been terminated by the Department.
ENCLOSURE 2: Fifth Third Bank’s Comments on the Draft Report
June 2, 2008

Gloria Pilotti
Regional Inspector General for Audit
Office of Inspector General
U.S. Department of Education
501 I Street, Suite 9-200
Sacramento, California 95814

Re: Fifth Third Bank’s Response to the Draft Audit Report
Control Number ED-OIG/A09H0017

Dear Ms. Pilotti:

On behalf of Fifth Third Bank ("Fifth Third"), I appreciate the opportunity to provide a response to the Draft Audit Report, which sets forth the preliminary findings and recommendations of the Office of Inspector General ("OIG") in connection with its audit of Fifth Third’s eligible lender trustee ("ELT") relationships. We have welcomed the OIG’s scrutiny, and, as a longtime participant in the Federal Family Education Loan ("FFEL") Program, we share the OIG’s desire to ensure the integrity and continued viability of FFEL.

After a thorough review of the pertinent facts and of the relevant legal authorities, we have determined that the findings contained within the Draft Audit Report lack a sufficient factual, legal, and policy basis. Indeed, the OIG’s primary finding is not supported by the unambiguous and plain language of the Higher Education Act of 1965, as amended ("HEA"), and it improperly purports to fundamentally change the Department’s administrative interpretation without prior notice to Fifth Third. Even more, less than ten years ago, the U.S. Department of Education ("Department") litigated the very same issue and lost decisively in federal court in Student Loan Marketing Association v. Riley. We, therefore, respectfully request that the OIG immediately terminate its audit or refrain from making any findings of non-compliance within a Final Audit Report.

We also disagree with the recommendations contained within the Draft Audit Report and respectfully request that those recommendations be significantly revised if a Final Audit Report ultimately includes findings of non-compliance. In particular, we request that the OIG not recommend that the Department terminate the federal guarantee on the over $3 billion of outstanding student loans in question or require reimbursement for amounts paid for default claims, interest, and special allowance on those loans. Such a sanction would be unprecedented, and the mere recommendation that the Department eliminate the federal guarantee and require over $300 million dollars in reimbursement on those loans could cause extreme disruption in the marketplace for securities backed by federally guaranteed student loans. The Department is taking important steps to alleviate the anxiety in student lending, and this recommendation could severely undermine those efforts. Fifth Third suggests that the OIG recommend, if anything, that the Department use informal compliance procedures, as it has done in the past, to address the issue.
We respectfully request that the OIG carefully review the document that we have enclosed, which, together with exhibits, constitutes Fifth Third’s formal response to the Draft Audit Report. In addition, we have enclosed for your consideration a document submitted by Student Loan Xpress, Inc., which, as you know, has a significant financial interest in this matter.

We encourage the OIG to reach out and to initiate further discussions with Fifth Third regarding the audit, generally, and Fifth Third’s response to the Draft Audit Report, specifically. We can assure you that such discussions will be treated with high priority.

At Fifth Third, we work to instill the same high standards of ethics and legal compliance that the OIG strives to instill through its audits and other investigative work. We, therefore, remain optimistic that this audit can be resolved amicably.

Thank you again for the opportunity to respond to the Draft Audit Report.

Sincerely,

Brian Gardner
Vice President, Asset Securitization

Enclosures
FIFTH THIRD BANK'S RESPONSE TO THE OIG'S DRAFT AUDIT REPORT

CONTROL NUMBER ED-OIG/A09H0017

June 2, 2008

FINDING NO. 1 -- Fifth Third Bank, as an ELT, Violated the Prohibition on Offering Incentives

Comments on the Finding

Introduction

The Higher Education Act's Prohibition Against Inducements

The Higher Education Act of 1965, as amended (“HEA”), authorizes the Federal Family Education Loan (“FFEL”) Program, a federally guaranteed student loan program in which loans made by eligible lenders are ultimately reinsured by the federal government in the event of default. See HEA, Title IV, Part B; 20 U.S.C. § 1071 et seq. The federal government additionally provides participating lenders interest benefits and special allowance payments. As a result, many lenders are willing to make student loans and more people can obtain a postsecondary education, which has become increasingly important in our digital and service economy.

The HEA has strict requirements regarding the type of entities that may serve as eligible FFEL lenders, which, as a result, generally limit eligible-lender status to banks, state agencies, and non-profit entities. See HEA § 435(d)(1); 20 U.S.C. § 1085(d)(1). However, an eligible lender, in its capacity as a trustee, may charge a fee to hold legal title to loans for other lenders that would otherwise be ineligible to make FFEL loans. See HEA § 426; 20 U.S.C. § 1076. The ineligible lenders become, under the trust, the sole beneficial owners of the loans, and they serve an important purpose in FFEL:

These trustee arrangements allow the ineligible lenders not only to originate loans, but also to purchase loans that other lenders have originated. This purchasing role -- the primary role for many ineligible secondary markets -- permits originating lenders to free up capital to make new loans to students. Eligible and ineligible lenders agree that participation by ineligible lenders increases competition among lenders and can, in turn, contribute to improved service and lower costs for student borrowers.\(^1\)


\(^1\) As of December 1999, eligible lender trustee arrangements accounted for $25.3 billion in outstanding FFEL loans -- approximately 19% of the outstanding balance of all FFEL loans. See GAO Report on ELT Arrangements, at 13. It is likely to be much higher today.
As an eligible lender trustee ("ELT"), the eligible lender is responsible for complying with all statutory and regulatory requirements imposed on holders of a FFEL loan. See HEA § 436(b); 20 U.S.C. § 1086(b); 34 CFR § 682.203(b). Importantly, a lender, including an ELT, can lose its status as an eligible lender if the Secretary of Education determines, after notice and an opportunity for a hearing, that the lender “offered, directly or indirectly, points, premiums, payments, or other inducements, to any educational institution or individual in order to secure applicants for [FFEL] loans.” HEA § 435(d)(5)(A); 20 U.S.C. § 1085(d)(5)(A). This condition for maintaining eligible-lender status, which was enacted in 1986, has come to be known as the “prohibition against inducements.”

The Department has always treated the purchase of actual loans by one lender from another lender quite differently than it has treated the purchase of loan applications, for purposes of the prohibition against inducements. For as many years as the Department has interpreted the HEA as prohibiting lenders from paying other entities a per loan fee for marketing, the Department has interpreted the HEA as permitting lenders to purchase, for a premium, actual consummated loans from other lenders. See Dear Colleague Letter 89-L-129, at 3 (February 1989) ("DCL 89-L-129"). In fact, the Department allows lenders to purchase loans from other lenders immediately following disbursement, enabling the purchasing lender to act as the agent of the selling lender on loans that are to be purchased. Id. (“The funds used to make the loan would be deemed to have been advanced to the seller by the purchaser and subsequently repaid from the sale proceeds.”). Indeed, federal regulations authorize a lender “to contract or otherwise delegate performance of its functions under [FFEL] to a servicing agency or other party.” 34 CFR § 682.203(a).

**FFEL Program Participants Have Adapted to the Department’s Interpretation**

The HEA does not prohibit marketers from adapting into lenders and making loans pursuant to an ELT agreement, and the Department has never questioned that practice through regulations, sub-regulatory guidance, or, until now, an audit of the Office of Inspector General ("OIG"). In fact, many successful FFEL lenders began as marketers and adapted to become lenders. The strict requirements of the HEA concerning lender eligibility, of course, require such entities to enter into ELT agreements with eligible lenders, such as Fifth Third Bank ("Fifth Third"), in order to originate FFEL loans. But if they do so, then these entities, the ELTs with which they partner, and the lenders that pay a premium for the loans they originate all adhere to the Department’s interpretation of the prohibition against inducements because the payments are made to purchase actual loans.

**Fifth Third Disagrees with the Finding**

The OIG’s finding of non-compliance necessarily relies upon a very broad interpretation of the HEA’s prohibition against inducements that defies the plain language of the HEA and that has been previously rejected by a federal court as an improper re-characterization of the roles of the parties. The OIG interprets the inducement prohibition to disallow payments by one lender to another lender for the purchase of actual FFEL loans under circumstances in which (1) the selling lender was previously a marketer that adapted into a lender by entering into an ELT agreement, (2) the selling lender did so for the purpose of originating and then immediately selling its FFEL loans, (3) the purchasing lender was a party to the selling lender’s ELT agreement, and (4) the selling lender outsourced most, if not all, its origination and servicing
responsible to third parties. In those instances, the OIG presumes that the selling lender is still a marketer, and, thus, the payments made by the purchasing lender to the selling lender were actually for the marketing of loan applications, and not for actual loans.

Fifth Third disagrees with the OIG's finding for two reasons, either one of which is sufficient to require the OIG to withhold a finding of non-compliance. First, the payments at issue were for the sale of actual loans, and not for the marketing of loan applications. To reach a contrary conclusion, the OIG must disregard the form of the transactions between each of the selling lenders and the purchasing lender. However, there is clear, legal precedent that concludes the language and purpose of the HEA would be frustrated by disregarding the form of this type of transaction. Additionally, the Department has always interpreted the prohibition against inducements to permit the type of sale of loans between lenders at issue here. The OIG cannot make a finding of non-compliance on the basis of a new administrative interpretation because the Department did not provide prior notice to Fifth Third of its fundamental change to the prior interpretation.

And second, the payments at issue were not prohibited because they were neither made to an "educational institution" nor to an "individual," as required by the plain language of the HEA. The recipients of the payments in question are neither educational institutions nor individuals. Rather, they are lenders that have originated Federal Consolidation Loans and have received payments from another lender upon the sale of those loans. The payments were, therefore, not prohibited by the HEA because they were made to neither an educational institution nor to an individual.

A. The Payments to the Selling Lenders Were Proper Because They Were for the Sale of Loans

1. The OIG's finding relies upon a statutory interpretation that was rejected by a federal court

In the Draft Audit Report, the OIG finds that Student Loan Xpress, Inc. ("SLX"), a lender for which Fifth Third served as ELT, made prohibited payments to three entities that entered into ELT agreements with Fifth Third in order to originate loans ("Selling Lenders"). The payments by SLX to the Selling Lenders complied with the HEA because there is a well-reasoned, federal court precedent permitting the very type of transaction at issue. The OIG's finding, which is premised on a statutory interpretation that has been squarely rejected by a federal court is, therefore, improper and should not be included within a Final Audit Report.

a. The Scholl College Case held that payments made pursuant to this type of transaction were permissible

The OIG finds non-compliance with the HEA's prohibition against inducements even though, less than ten years ago, a federal district court rejected the Department, on the merits, in its attempt to sanction a lender under nearly identical facts and circumstances. In Student Loan Marketing Association v. Riley, the United States District Court for the District of Columbia overturned the Department's determination that a lender had paid a college, which was acting as a lender itself, an improper inducement under section 435(d)(5)(A) of the HEA, 20 U.S.C. § 1085(d)(5)(A), finding the Department's determination arbitrary and capricious. Student Loan Marketing Ass'n v. Riley, 112 F. Supp.2d 38 (D.D.C. 2000) ("The Scholl College Case").
The transaction in *The Scholl College Case* is very similar to the transactions between SLX and the Selling Lenders. In *The Scholl College Case*, the Dr. William M. Scholl College of Podiatric Medicine ("Scholl College") was an eligible lender under FFEL. *The Scholl College Case*, 112 F. Supp.2d at 40. When Scholl College became a lender, it entered into agreements with the Student Loan Marketing Association ("Sallie Mae"), whereby Sallie Mae financed the student loans, processed the student loan applications, and originated the student loans on behalf of Scholl College. *Id.* Scholl College also entered into a forward-purchase agreement with Sallie Mae that required the college to sell its loans to Sallie Mae. *Id.* When the loans were purchased, Scholl College received the full principal balance and accrued interest, as well as an "incentive fee" of up to 2.5%. *Id.*

**The Administrative Enforcement Proceeding**

In July 1995, the Department initiated an administrative enforcement proceeding against Sallie Mae to limit its eligibility to participate in FFEL. *The Scholl College Case*, 112 F. Supp.2d at 41. The Department alleged that the premium paid by Sallie Mae to Scholl College provided an inducement to Scholl College to steer students to Sallie Mae, in contravention of section 435(d)(5)(A) of the HEA, 20 U.S.C. § 1085(d)(5)(A). Decision, *In the Matter of Student Loan Mktg. Ass'n (Sallie Mae)*, Dkt. No. 96-23-SL (Sept. 26, 1996) ("Initial ALJ Decision"). The Department’s theory was that the form of the transaction between Sallie Mae and Scholl College should be disregarded, and Scholl College should be re-characterized in the transaction as an educational institution, as opposed to the originating lender. *Id.* at 5. Once that is done, the Department asserted, the fee paid by Sallie Mae to Scholl College becomes a payment made by a lender to an educational institution in order to secure loan applications. *The Scholl College Case*, 112 F. Supp.2d at 41.

An administrative law judge ("ALJ") rejected the Department’s contentions and ruled for Sallie Mae in a written decision in September 1996. The judge noted that the Department explicitly permitted lenders to offer premiums to each other on the sale of loans in order to enhance liquidity. Initial ALJ Decision, at *5. Refusing to disregard the form of the transaction, the ALJ found that Sallie Mae had complied with the HEA because the fee was paid for actual loans, not loan applicants. *Id.* The judge further found that there was no evidence of Scholl College encouraging parents or students to take out unnecessary student loans, or of any fraudulent activities by Scholl College. *Id.* After noting the Department’s concession that the situation would be permissible if the selling lender was not a school, the judge concluded that the Department was "attempting to legislate a prohibition which exceeds the bounds of the enabling statute." *Id.*

The Department appealed the ALJ’s decision to the Secretary of Education. In February 1997, the Secretary remanded the case to the ALJ to consider whether the Department could "characterize a party as a lender under the FFEL program based on the substance of the transactions involved and in spite of their form." *The Scholl College Case*, 112 F. Supp.2d at 41.

The ALJ issued a written decision on remand in July 1997, in which he responded to the Secretary’s query by stating that the form of the transaction could not be disregarded. The ALJ held that, pursuant to the agreements signed by the parties, Scholl College, and not Sallie Mae, was the originator of the loans. Decision Upon Remand, *In the Matter of Student Loan Mktg. Ass’n (Sallie Mae)*, Dkt. No. 96-23-SL (July 18, 1997) ("ALJ Decision Upon Remand"). Thus,
the ALJ concluded, the premium paid to Scholl College for the loans was not an impermissible inducement for loan applications, but a payment for the sale of actual loans. *The Scholl College Case*, 112 F. Supp.2d at 41. And the court again noted the Department’s admission that the same transaction between two non-school lenders would be permissible. *ALJ Decision Upon Remand* at *3.

The ALJ’s order on remand was appealed, and the Secretary overturned the judge. *The Scholl College Case*, 112 F. Supp.2d at 41.

Sallie Mae sued the Department in the United States District Court for the District of Columbia, contending that the Secretary’s decision was arbitrary, capricious, an abuse of discretion, and otherwise contrary to law, in violation of the Administrative Procedures Act (“APA”), 5 U.S.C. § 706. *The Scholl College Case*, 112 F. Supp.2d at 42.

**The District Court Decision**

At the district court, the Department’s defense of its enforcement action rested on showing that Sallie Mae, and not Scholl College, was the originating lender. *The Scholl College Case*, 112 F. Supp.2d at 43. Only then could the Department demonstrate that the payments were not between lenders for the sale of loans. The Department admitted that each of the contracts comprising the transaction was individually permissible, meaning that (1) it was permissible for Sallie Mae to agree to provide funding to Scholl College to enable the school to originate student loans, (2) it was permissible for Sallie Mae to agree to provide Scholl College loan origination and servicing support, and (3) it was permissible for Sallie Mae to agree to purchase from Scholl College all of the student loans the school was to originate. *Id.* at 47. However, the Department contended that the *combination* of the contracts created a relationship between the parties in which the payments made by Sallie Mae to Scholl College were impermissible inducements. *Id.* at 46. The Department argued that a review of the transaction, as a whole, showed that Scholl College was not the originating lender, but, instead, a mere loan marketer for Sallie Mae.

The district court first found that nothing prevented school lenders, such as Scholl College, from delegating essentially all of their functions to Sallie Mae, “even if the arrangement effectively renders the school lender a mere marketer of loans.” *The Scholl College Case*, 112 F. Supp.2d at 44 (emphasis added). The court noted that such delegations are expressly permitted under the Department’s regulations and that “a lender does not shed its status as the lender in a transaction even if its functions are delegated to a third party.” *Id.* The court also held that neither Scholl College’s failure to bear the real risks of the lending, nor unproven and unalleged concerns about student and parent coercion, justified ignoring the college’s status as a lender. *Id.* at 44-45.

The court also declined to disregard the form of the transaction between Scholl College and Sallie Mae because the HEA placed an emphasis on form. See *The Scholl College Case*, 112 F. Supp.2d at 46 (finding that it can be inferred from the HEA “that the statute placed an emphasis on form, and that the form is not to be ignored even where the underlying substantive duties are assigned to another party”) (emphasis added). The Department had not alleged that Sallie Mae was somehow using the structure or labels to gain an improper advantage, or that Sallie Mae exercised any involvement or control over Scholl College. *Id.*
In response to the Department’s contention that the court should find the agreements, in combination, between Scholl College and Sallie Mae impermissible, the district court noted that, through the HEA, “Congress has recognized that the individual agreements between [Sallie Mae] and Scholl College are permissible,” and that “Congress clearly intended to grant [Sallie Mae] broad discretion in structuring its loan purchase agreements.” The Scholl College Case, 112 F. Supp.2d at 46. In addition, Department regulations provided that Scholl College could delegate its duties as a lender. Id.

Moreover, because the agreements were indicative of “traditional market transactions,” and the forward-purchase agreement was negotiated with competitive pricing, Scholl College gained no more from the transactions “than it would if the loan purchaser and loan financer were different parties.” Id. at 46-47. The court also noted that official guidance from the Department, in the form of the 1989 Dear Colleague Letter, stated that the type of transaction involved here was an example of an arrangement that would comply with the prohibition against inducements. Id. at 48. Consequently, there was, as the court put it, “no rational basis for invalidating the total arrangement.” Id.

Finally, and most significantly for the matter at hand, the court noted that the Department “has conceded that the same set of transactions would be permissible if it involved contracts between two non-school lenders.” The Scholl College Case, 112 F. Supp.2d at 48. In short, the Department had represented to the court that if the situation was the same, except Scholl College was replaced by a different kind of lender, then the Department would have had “no complaint.” Id.

b. The OIG’s finding of non-compliance is indistinguishable from the Department’s unsuccessful administrative enforcement proceeding in The Scholl College Case

The facts and circumstances of The Scholl College Case are virtually indistinguishable from those involved here. In The Scholl College Case, the originating lender was a school. But, just as Sallie Mae provided funding to Scholl College to enable it to originate student loans as a lender, so, too, did SLX provide funding to three entities to enable them to originate student loans as lenders. And just as Sallie Mae provided loan origination and servicing support to Scholl College and agreed to purchase from Scholl College all of the student loans it was to originate, so, too, did SLX. As in The Scholl College Case, several agreements were entered into between SLX and the Selling Lenders in order to effectuate the origination and servicing of FFEL loans, as well as the sale of those loans from the Selling Lenders to SLX -- a transaction that the Department has expressly condoned since 1989. See DCL 89-L-129, at 3. It is also a transaction that any prudent ELT would facilitate in order to ensure that the loans in the trust are properly funded, serviced, and committed for sale to an experienced, well-financed FFEL loan holder.

The form of the agreements between SLX and the Selling Lenders, like the form of the agreements in The Scholl College Case, were typical of transactions on the secondary market. In The Scholl College Case, the Department attempted to disregard the form of the transaction because it thought the combination of the agreements suggested that Sallie Mae, and not Scholl College, was the originating lender. Similarly, the OIG’s finding is premised on disregarding the form of the transactions to determine that the combination of the agreements suggest that SLX,
and not the Selling Lenders, was the originating lender. See Draft Audit Report, at 6 ("[U]nder the ELT agreement, MSA remained solely a marketer, that is, an entity that secured loan applications for lenders."). The OIG's disregard of the form of the transactions that placed entities in the role of lender is unpersuasive here for the same reasons the Department’s disregard of Scholl College as a lender was unpersuasive, and rejected outright, in The Scholl College Case.

The OIG identifies three particular aspects of the transactions that lead it to disregard the form of the transactions: (1) "the origination of [the Federal Consolidation Loans] was restricted to those exclusively funded, serviced, and purchased by SLX and its affiliates"; (2) "SLX [transferred] its interest in the loans held in one trust . . . to another trust;" and (3) "the role of [the Selling Lenders] was limited to the securing of loan applications (marketing) and obtaining loan verification certificates." Draft Audit Report at 5-6. However, all of these actions are either authorized by the HEA or are otherwise permissible. Consequently, the OIG cannot cite to them to support the view that the payments from SLX to the Selling Lenders were actually for loan applications, as opposed to actual loans. OIG has neither a factual nor a legal basis to re-characterize the Selling Lenders as marketers in order to allege that SLX made improper inducement payments to them.

Forward-Purchase and Third-Party Servicing Agreements

The Draft Audit Report questions the legality of the forward-purchase and third-party servicing agreements between the Selling Lenders and SLX (or its affiliates). In essence, the OIG finds problematic the fact that the Selling Lenders agreed in advance to sell their Federal Consolidation Loans to SLX and to have them funded and serviced by SLX affiliates. See Draft Audit Report, at 5 ("Under the terms of the ELT agreements and related agreements, MSA, PLP, and LSF are not lenders since the origination of FFELs is restricted to those exclusively funded, serviced, and purchased by SLX and its affiliates . . . ."). But the OIG's characterization of these agreements as evidence of prohibited inducements is factually untenable, and the OIG cited no legal authority to support its view.

The form of each agreement within the transaction is clear on its face. The ELT agreements, which were consummated following arms-length negotiations between the parties, laid the groundwork for a myriad of rights and obligations of the Selling Lenders in several other related agreements. For example, the third-party servicing agreements involved the outsourcing by the Selling Lenders of certain origination and servicing functions to SLX or its affiliates. And the forward-purchase agreements required the sale of actual loans by the Selling Lenders to SLX.

In addition, forward-purchase and third-party servicing agreements are not prohibited by statutes or regulations. In fact, federal regulations provide express authority for SLX and its affiliates to service Federal Consolidation Loans originated by the Selling Lenders at prices and on terms and conditions determined by the contracting parties. See 34 CFR § 682.203(a) ("A school, lender, or guaranty agency may contract or otherwise delegate the performance of its functions under the [HEA] and [Part 682 of Title 34 of the Code of Federal Regulations] to a

---

2 And The Scholl College Case involved payments to a school, where the concerns regarding the pernicious effects of improper inducements are the greatest because of the influence schools have over their student-borrowers in selecting a FFEL lender.

- 7 -
servicing agency or other party.”). This outsourcing authority is -- by its own terms -- very broad, permitting lenders to delegate any lending function. *The Scholl College Case*, 112 F. Supp. 2d at 44 (“The regulation does not limit in any way how lending functions may be delegated; nor does it exclude any lending functions from delegation.”). Despite the OIG’s effort to call into question the Selling Lenders’ use of third-party servicing agreements, nothing in the regulation can be reasonably interpreted to separate the role of lender and the role of a marketer that has adapted into a lender to originate loans pursuant to an ELT agreement. *See id.* (“[T]he regulation cannot be reasonably interpreted as expressing a ‘clear intent to separate the role of the lender and the school,’ as claimed by [the Department].”).

Forward-purchase agreements are expressly permitted by the Department, and they have been described by the Department as a way in which lenders can comply with the prohibition against inducements. In its 1989 Dear Colleague Letter, under the heading “Examples of Permissible Activities,” the Department expressly authorized the sale of loans between lenders and provided specific guidance regarding the nature of the sale and the role a purchasing lender may play in its acquisition of the loans from the selling lender:

**Examples of Permissible Activities:**

1. A lender purchases a loan made by another lender at a premium. This is not a transaction involving the securing of applicants, but rather the acquisition of loans already made. A purchasing lender may also act as the agent of a selling lender on a loan *to be purchased* for purposes of originating and disbursing the loan, and purchase the loan at a premium immediately following disbursement. The funds used to make the loan would be deemed to have been advanced to the seller by the purchaser and subsequently repaid from the sale proceeds.

DCL 89-L-129 (emphasis added).

For the past 20 years, the Department has interpreted the HEA to authorize a lender’s acquisition of loans immediately following disbursement under circumstances in which the agreement to acquire such loans is struck before the loans are ever made by the selling lender, *i.e.*, a forward-purchase agreement. Even more, the excerpt shows that the Department has, for just as long, expressly authorized a purchasing lender to act as the agent of the selling lender by advancing the necessary funds to the selling lender and by providing other third-party assistance that aids the selling lender in the origination and servicing of the loans. The Department has never modified its position regarding the legality of forward-purchase agreements between lenders.

**SLX’s Transfer of Interest from one Trust to Another Trust**

The Draft Audit Report found troubling the fact that SLX was a party to the ELT agreements between Fifth Third and the Selling Lenders, which agreements set forth, among other things, that the ELT relationships were being formed to effectuate the sale of loans from
the Selling Lenders to SLX. See Draft Audit Report, at 6. The OIG’s concern is that, as a party to the ELT agreements, SLX seemed to have had an “interest” in the loans held in trust by Fifth Third for the Selling Lenders that, upon SLX’s purchase of those loans, was transferred to another trust for which Fifth Third served as ELT. This, the OIG concludes, shows that the transaction was not for a sale of loans from one lender to another lender but, rather, the mere transfer of SLX’s loans from one trust to another trust.

The ELT agreements created separate trusts, each with its own existence and its own set of rights and obligations for the parties. By the terms of each ELT agreement, Fifth Third held the loans constituting trust property “for the benefit of [the Selling Lender],” and the ELT agreement required such loans to be “held, administered and pledged and the proceeds thereof distributed by [Fifth Third] for the benefit of [the Selling Lender].” See, e.g., ELT Agreement Between Fifth Third and Pacific Loan Processors, Inc., at Sections 1.1 and 1.2 (Apr. 1, 2005).

In this case, SLX’s role under the ELT agreements was limited. Its duties were largely ministerial, and its obligations were basically to pay, on the Selling Lenders’ behalf, the costs of commencing and maintaining the Selling Lenders’ ELT agreements -- an obligation that could have easily been included within the forward-purchase agreements or omitted altogether in favor of an increase in the premiums. The inclusion of SLX as a party to the ELT agreements neither created a beneficial interest of SLX in the loans residing in the trusts, nor diminished the full and exclusive beneficial ownership interest of the Selling Lenders in the loans residing in the trusts. The OIG’s conclusion that SLX transferred an interest from one trust to another trust is, therefore, not supported by the facts because the terms of the Selling Lenders’ ELT agreements shows that SLX had no beneficial ownership interest in those trusts. Additionally, nothing in the ELT agreements suggested that SLX’s presence interfered in any way with the Selling Lenders’ ability, as the sole beneficial owners of the trust property, to effectuate a valid sale of Federal Consolidation Loans to SLX.

The form of the ELT agreements in question indicates that those agreements created legally enforceable trustee-beneficiary relationships between Fifth Third and the Selling Lenders, not between Fifth Third and SLX. There is nothing in the ELT agreements that provides SLX a beneficial interest in the trusts established thereunder. Pursuant to the ELT agreements, actual Federal Consolidation Loans were originated by the Selling Lenders, acting through Fifth Third, and were held exclusively by Fifth Third for the benefit of each Selling Lender. The form of the transactions clearly demonstrates that the Selling Lenders, and not SLX, originated Federal Consolidation Loans that were held by Fifth Third as ELT.

The Limited Role of the Selling Lenders

Nothing in the HEA or federal regulations prohibited the Selling Lenders from entering into third-party servicing agreements to outsource most of their duties and functions as lenders, even though doing so may have significantly limited the role of the Selling Lenders primarily to the marketing of loans. See The Scholl College Case, 112 F. Supp.2d at 44 (“[N]othing in the statute or regulations prohibits a [] lender from establishing a relationship with a third-party

\[3\] The OIG is so troubled by this one factor that its absence from several of Fifth Third’s other ELT agreements is the sole reason cited by the OIG for not also including those transactions within the Draft Audit Report’s findings. See Draft Audit Report, at 12.
servicer ... even if the arrangement effectively renders the [] lender a mere marketer of loans.

The Draft Audit Report nevertheless questions the limited role of the Selling Lenders, derisively describing their role as one only involving “the securing of loan applications (marketing) and obtaining loan verification certificates.” Draft Audit Report, at 6. The OIG concludes that, despite their ELT agreements with Fifth Third, each Selling Lender “remained solely a marketer, that is, an entity that secured loan applications for lenders.” Id. However, the HEA, itself, expressly authorizes lenders to take as limited a role as they desire and many lenders, including the Selling Lenders, have properly done that.

The Draft Audit Report’s conclusion that the Selling Lenders’ limited role supports treating the form of the transactions as fiction is unsupported by any factual or legal analysis. The fact that the Selling Lenders held the loans during a period in which they had very few servicing obligations and assumed reduced financial risk does not lead to the conclusion that SLX was actually the originating lender. See The Scholl College Case, 112 F. Supp.2d at 44. The Selling Lenders did, of course, assume some financial risk in the form of repurchase obligations under the forward-purchase agreements, as well as compliance risk and reputation risk. Still, the Congress did not intend to inject uncertainty into the HEA’s application by making the identification of the originating lender dependent upon the breadth of responsibilities undertaken by the entity. Id. at 45.

The Department’s regulations expressly authorize lenders to delegate the performance of their lender functions under the HEA but holds them responsible for compliance. See 34 CFR § 682.203(a). Thus, whether the lender is a “traditional lender” or a marketer that recently became a lender pursuant to an ELT agreement, it bears the same risk when it “contract[s] with one party to handle all of its originating and servicing functions, contract[s] with another party to obtain capital to fund its loans, and contract[s] with still another party to sell its loans once they have been disbursed.” Id. at 44. It is, therefore, of no legal significance that the Selling Lenders’ role was limited on account of the forward-purchase and third-party servicing agreements because, again, “nothing in the statute or regulations prohibits a [] lender from establishing a relationship with a third-party servicer ... even if the arrangement effectively renders the [] lender a mere marketer of loans.” Id.

The “Combination” Approach

The Draft Audit Report suggests that it is the combination of the contractual rights and obligations between the Selling Lenders and SLX, rather than any particular provision, that transgresses the prohibition against inducements. Thus, the OIG takes the same “combination” approach in the Draft Audit Report that was squarely rejected by the court in The Scholl College Case. See The Scholl College Case, 112 F. Supp.2d at 48 (“[A] prohibition cannot be manufactured by a recasting of the roles of the parties in an attempt to argue, as [the Department] does here, that the contractual arrangements, when taken as a whole, violate the spirit of the anti-inducement provision of the statute.”). The OIG does not mention, let alone attempt to distinguish, The Scholl College Case within its finding. Plainly, it cannot do so. There is no material difference between the two.

The arrangements between the Selling Lenders and SLX, like the arrangements between Scholl College and Sallie Mae, “are characteristic of traditional market transactions between lenders.” The Scholl College Case, 112 F. Supp.2d at 46. Selling student loans in the secondary
market at a premium, or at an amount above par, is typical. *Id.* at 47. Pursuant to the forward-purchase agreements, the premium is computed by multiplying a premium percentage times the principal amount of each loan sold during the preceding half-month. The premium percentages increase as the principal amount of the loans increases. The OIG has not contested that the forward-purchase agreements were negotiated using competitive, market pricing. Thus, the Selling Lenders gained no more from the transactions with SLX than would any other lender. Consequently, the payments made by SLX to the Selling Lenders did not provide any unreasonable incentive to take certain actions and, therefore, cannot be said to “rise to the level of an improper inducement.” *Id.*

All of the agreements, and the various aspects thereof, that are challenged by the OIG are permissible under the HEA. Taken together, these agreements show no more than that the payments from SLX to the Selling Lenders were for the purchase of loans by one lender from another lender. As the court noted in *The Scholl College Case*, the Department issued guidance nearly 20 years ago informing lenders that these types of agreements, in combination, are permissible. *See The Scholl College Case*, 112 F. Supp.2d at 48 (“[The Department] implied in the [Department’s] first official guidance given to lenders, the 1989 DCL, that agreements such as those existing between [Scholl College] and Sallie Mae are unobjectionable in combination, as an analogous transaction was given as an example of a permissible activity.”).

The OIG’s finding seeks to impose its own policy preferences and to replace the policy preferences and legal interpretations that were previously expressed by the Department in the 1989 Dear Colleague Letter. Since 1989, the Department has generally permitted the type of arrangement at issue here, and, subsequently, in *The Scholl College Case*, the Department represented to a federal court that the payments made pursuant to this very arrangement are specifically permissible.

2. **The Department cannot change its interpretation of the inducement prohibition without prior notice**

Federal agencies are required to give notice of a change in administrative interpretation before taking enforcement action pursuant to the revised interpretation. *See Long Island Care at Home, Ltd. v. Coke*, 127 S. Ct. 2339, 2349 (2007) (holding that changes in regulatory interpretations are acceptable unless unfair surprise results); *Abhe & Svoboda, Inc. v. Chao*, 508 F.3d 1052 (D.C. Cir. 2007) (holding that regulations must provide fair notice of prohibited conduct in order for penalties to be deemed appropriate). In fact, under the Administrative Procedures Act (“APA”), 5 U.S.C. § 551(5), agencies are required to engage in notice-and-comment rulemaking to change regulatory interpretations. *See Paralyzed Veterans of America v. D.C. Arena L.P.*, 117 F.3d 579, 586 (D.C. Cir. 1997).

In *Paralyzed Veterans*, a group challenged the lower court’s decision regarding lines of sight for wheelchair-bound patrons at an arena. *See Paralyzed Veterans*, 117 F.3d at 582. One of the grounds for appeal was that the agency’s current interpretation of the governing regulation was “a fundamental modification of its previous interpretation” and that such a change could not be made “merely by revising the technical manual.” *Id.* at 586. Although the court of appeals ultimately held that the manual constituted the agency’s initial regulatory interpretation and, thus, did not require rulemaking in order to become effective, it held that rulemaking is required before an agency can make a fundamental change to a regulatory interpretation. *Id.* (citing
Similarly, in this matter, the OIG is proposing a fundamental change to the administrative interpretation of the prohibition against inducements. The existing interpretation is that a transaction between lenders for the sale of loans is expressly permitted. Fifth Third and the lenders for which it served as ELT relied upon that interpretation in structuring the transaction at issue here. Over the years, billions and billions of dollars in FFEL loans were originated in reliance on that interpretation. But now, the OIG is proposing to make a finding of non-compliance for that very type of transaction, and it is doing so without prior notice to Fifth Third of the fundamental change of interpretation. The OIG is taking this action in spite of the Department's recently published Final Rule that amends the regulations to expressly permit this type of transaction.

The Department offered its first authoritative interpretation of the HEA's anti-inducement provision in February 1989 when it issued a “Dear Colleague letter” to the student lending community. See DCL 89-L-129. In that sub-regulatory guidance document, the Department stated that a sale of loans between lenders complies with the HEA's anti-inducement provision. It even went so far as to say that the purchasing lender could also act as the agent of the selling lender by taking on the selling lender's originating and servicing responsibilities, including the provision of funds to the selling lender to originate the loans. Aside from advancing the view in the mid to late 1990s that this "safe harbor" did not apply where a school was the selling lender - - a view ultimately rejected in The Scholl College Case -- the Department has never changed its interpretation of the inducement prohibition in connection with the sale of loans. Indeed, it has recently done the complete opposite -- it has amended the regulations, effective July 1, 2008, to expressly permit the payment of a premium upon a sale of loans from one lender to another lender:

(ii) Notwithstanding paragraph (5)(i) of this definition, a lender, in carrying out its role in the FFEL program in attempting to provide better service, may provide

***

(H) Purchase of a loan made by another lender at a premium.


The OIG's finding of non-compliance in the Draft Audit Report relating to payments made in furtherance of the sale of loans between the Selling Lenders and SLX -- two non-school lenders -- would be a fundamental change to an administrative interpretation. Even more, it

---

4 Throughout the litigation of The Scholl College Case, the Department made its case regarding the illegality of Sallie Mae's payments to Scholl College by, among other things, drawing a distinction between those payments and payments made between two non-school lenders. See
would be a change in interpretation made solely for the purpose of the OIG’s audit of Fifth Third, and it would be a change in interpretation that was made without prior notice, thus, creating undue surprise. As such, it would be improper for the OIG to make that finding. The Department is bound by its prior administrative interpretation unless and until it provides notice of a fundamental change to that interpretation.

3. **The payments for Federal Consolidation Loans did not involve any of the risks targeted by the HEA’s prohibition against inducements**

The HEA’s prohibition against inducements was intended to “foreclose the possibility of exploitation of student and parent borrowers” so as to discourage them from engaging in “unnecessary or excessive borrowing.” *The Scholl College Case*, 112 F. Supp.2d at 45. The payments at issue here were, however, for the purchase of Federal Consolidation Loans, which involve the consolidation of existing loans, as opposed to the borrowing of additional sums of money for new loans. The origination of Federal Consolidation Loans does not increase the principal amount of debt owed by parent and student borrowers and, therefore, cannot lead student and parent borrowers to incur unnecessary debt.

Even more, the Department’s understandable concern with the influence schools have over the selection by student and parent borrowers of a FFEL lender does not arise here. The payments at issue were made by one lender to another lender. No party attempted to influence the behavior of borrowers by offering payments to schools or to borrowers directly. As such, the payments here had no direct impact on borrowers and no impact at all on schools. The Draft Audit Report does not identify, or even suggest, any behavior by Fifth Third that harmed borrowers.

**B. The HEA’s Prohibition Against Inducements Does Not Cover the Recipients of the Payments Here**

The statutory definition of an “eligible lender” under the HEA specifically excludes lenders that have “offered, directly or indirectly, points, premiums, payments, or other inducements, to any educational institution or individual in order to secure applications for loans.” HEA § 435(d)(5)(A); 20 U.S.C. § 1085(d)(5)(A) (emphasis added). Whether the entities to which such payments are made are lenders or marketers makes no difference because the HEA’s prohibition against inducements only applies to payments made to “any educational institution or individual.” The Selling Lenders were neither, and the Department cannot, through the issuance of regulations and sub-regulatory guidance, expand the scope of covered recipients that the HEA clearly and unambiguously limits to educational institutions and individuals.

---

*The Scholl College Case*, 112 F. Supp.2d at 48 (“[The Department] has conceded that the same set of transactions would be permissible if it involved contracts between two non-school lenders.”).

5 The payments were, therefore, far removed from the types of problematic payments identified by a key witness for the Department in *The Scholl College Case*, e.g., lenders giving away electronic goods to borrowers.
1. The OIG’s finding necessarily relies upon an interpretation of the inducement prohibition that is contrary to the plain language of the HEA.

   a. The OIG’s finding is not consistent with clear and unambiguous language within the HEA that only prohibits inducement payments to “any educational institution or individual.”

A court will look no further than the plain language of the statute when it is called upon to review the validity of agency action. See Chevron U.S.A. v. Natural Resources Defense Council, 467 U.S. 837, 842 (1984). Under Chevron, the first step for determining the validity of agency action is for the court to analyze whether “Congress has directly spoken to the precise question at issue.” Id. If Congress has spoken to the question, then the agency and, if necessary, the courts “must give effect to the unambiguously expressed intent of Congress.” Id. It is incumbent upon the agency to take only those actions that are consistent with clear and unambiguous statutory language:

   In determining whether a challenged regulation is valid, a reviewing court must first determine if the regulation is consistent with the language of the statute. “If the statute is clear and unambiguous ‘that is the end of the matter, for the court, as well as the agency, must give effect to the unambiguously expressed intent of Congress.’ . . . The traditional deference courts pay to agency interpretation is not to be applied to alter the clearly expressed intent of Congress.”

K Mart Corp. v. Cartier, Inc., 486 U.S. 281, 291 (1988) (emphasis added; internal citations omitted); see Zuni Public Schools Dist. No. 89 v. Department of Education, 127 S. Ct. 1534, 1543 (2007) (“Under this Court’s precedents, if the intent of Congress is clear and unambiguously expressed by the statutory language at issue, that would be the end of our analysis.”); Barnhart v. Sigmon Coal Co., 534 U.S. 438, 461 (2002) (“In the context of an unambiguous statute, this Court need not contemplate deferring to an agency’s interpretation.”); Estate of Cowart v. Nichols Drilling Co., 505 U.S. 469, 475-77 (1992) (“Of course, a reviewing court should not defer to an agency position which is contrary to an intent of Congress expressed in unambiguous terms.”).

If the statute is clear and unambiguous -- that is, if the Congress has directly spoken to the precise question at issue -- then the agency must follow the letter of the statute and take only those actions that are consistent with the literal words of the statute. Agency actions that rely for their justification upon authorities outside of the literal words of a clear and unambiguous statute are improper and will be struck as invalid. See Financial Planning Ass’n, Inc. v. SEC, 482 F.3d 481, 492 (D.C. Cir. 2007) (agency could not use statutory provision granting authority to exempt additional groups to issue regulations expanding statute’s application); Amalgamated Transit Union v. Skinner, 894 F.2d 1362, 1364 (D.C. Cir. 1990) (statutory language authorizing specific federal intervention into local safety programs did not give the Urban Mass Transportation Administration authority to institute a drug-testing program on all recipients of its grants).

Three circuits have declined to allow a regulation issued under the Family Medical Leave Act (“FMLA”) to impose an additional legal requirement in light of the plain language of the statute that speaks to the precise issue. See Woodford v. Community Action of Greene County, Inc., 268 F.3d 51, 56-57 (2d Cir. 2001); Brungart v. BellSouth Telecommunications, Inc., 231
F.3d 791, 797 (11th Cir. 2000), cert. denied, 532 U.S. 1037 (2001); Dormeyer v. Comerica Bank - Illinois, 223 F.3d 579, 582 (7th Cir. 2000). In Woodford, the plaintiff challenged the lower court’s ruling that she had not worked the requisite number of hours to be covered under the FMLA. See Woodford, 268 F.3d at 52. The statute required that a person work a certain number of hours to be eligible under FMLA, but a regulation allowed a person lacking the minimum hours to qualify if he requested leave and the employer confirmed eligibility. Id. at 54-55. In line with decisions in the Seventh and Eleventh Circuits, the Second Circuit upheld the lower court’s ruling that the regulation was too broad because it could allow an employee who did not meet the statutory hours requirement to receive benefits. Id. at 56-57. The Woodford court found that the congressional intent was clear from the language of the statute. Id. at 55. The regulation was inconsistent with the literal words of the statute and was, thus, struck as invalid. Id.

At least one federal court has examined this issue in the context of whether action taken by the Department was consistent with the clear and unambiguous language of the HEA. In Sandler v. United States Dep’t of Education, No. CIV. A. 00-CV-4432, 2001 WL 884552 (E.D. Pa. July 19, 2001), the court ruled in favor of a borrower who had been denied a discharge of her FFEL loan following her withdrawal from a school that announced it was closing. Relying upon a regulation that requires borrowers to withdraw from a school not more than 90 days before its closing in order to receive a loan discharge, the guaranty agency designated by the Department had denied the borrower’s request for a discharge. See 34 CFR § 682.402(d)(1)(i) (“The Secretary reimburses the holder of a loan ... and discharges the borrower’s obligation with respect to the loan, if the borrower ... withdrew from the school not more than 90 days prior to the date the school closed.”).

The court, however, noted that the HEA, which addresses the issue of loan discharge upon the closure of a school, imposes no such time limitation:

If a borrower ... is unable to complete the program due to the closure of the institution ... then the Secretary shall discharge the borrower’s liability on the loan (including interest and collection fees) by repaying the amount owed on the loan and shall subsequently pursue any claim available to such borrower against the institution. . . .

HEA § 437(c); 20 U.S.C. § 1087(c) (emphasis added). Because the HEA specifically addresses the issue clearly and unambiguously, the borrower was entitled to have her loan discharged. See Sandler, 2001 WL 884552, at *1-2 (“The plain meaning of the statute clearly is that when a student is unable to complete his or her program due to the closure of the school, the Secretary shall discharge the borrower’s liability on the loan.”).

Just as the HEA directly speaks to the issue of loan discharge upon school closures, so, too, does the HEA directly speak to the issue of prohibited inducements. In both contexts, the statutory language is clear and unambiguous. The HEA conditions a lender’s status as an “eligible lender” upon its ability to refrain from offering inducement payments to “any educational institution or individual.” HEA § 435(d)(5)(A); 20 U.S.C. § 1085(d)(5)(A).

Consequently, the Department must follow the letter of the HEA and only take administrative enforcement action where payments for loan applications are made by lenders to “any
educational institution or individual.” Enforcement actions that involve payments to other classes of recipients are improper and, if challenged in court, will be struck as invalid.

None of the recipients of the payments at issue here are, or have ever been, any kind of “educational institution,” under any plausible definition of that term. Thus, the OIG’s finding of non-compliance necessarily relies on the payments having been made to “individuals.” It would, therefore, have to be the OIG’s position that, when Congress used the term “individual” in section 435(d)(5)(A) of the HEA, 20 U.S.C. § 1085(d)(5)(A), it included legal entities, such as the Selling Lenders here. Because such an interpretation runs contrary to the definitions provided in the United States Code, as well as to the structure of the very statutory provision in question, the OIG should not rely on the payments to the Selling Lenders to make a finding of non-compliance.

b. The HEA’s use of the term “individual” is not synonymous with “person” and, thus, does not cover the Selling Lenders

An interpretation of “individual” to include legal entities, such as the Selling Lenders, requires blurring the distinction between the use of “individual” and “person” in statutory drafting. In normal usage, the words are often used as synonyms for “human being,” but “person” often has a broader meaning in the law.” Clinton v. City of New York, 524 U.S. 417, 428 (1998) (noting the distinction between “person” and “individual” and how “person,” and not “individual,” covers corporations). Indeed, the term “person” is described in the primary definitions section of the United States Code as including legal entities (such as corporations and partnerships), as well as individuals. See 1 U.S.C. § 1 (“[T]he words ‘person’ and ‘whoever’ include corporations, companies, associations, firms, partnerships, societies, and joint stock companies, as well as individuals”).

Therefore, when used in federal statutes, the term “individual” is a subset of “person” and, as a result, cannot carry the same legal meaning. While a “person” can be either a legal entity or a human being, an “individual” can only be a human being. The HEA’s inducement prohibition, which covers payments to “any educational institution or individual,” then, covers only those payments made to educational institutions or human beings -- a much more narrow class of recipients than that which would be covered by the term “person.” If Congress intended to prohibit payments to legal entities other than educational institutions, such as corporations and partnerships, then it would have used the term “person.”

Another place to look to discern the meaning of “individual,” as used in the HEA’s anti-inducement provision, is the context in which it is used. See Whitman v. American Trucking Ass’n, 531 U.S. 457, 471 (2001) (“The text of § 109(b), interpreted in its statutory and historical context and with appreciation for its importance to the CAA as a whole, unambiguously bars cost considerations from the NAAQS-setting process, and thus ends the matter for us as well as the EPA.”). In this case, the provisions of the HEA that appear with the anti-inducement provision in section 435(d)(5) focus on offers of payment (or other conduct) directed toward human beings. For example, section 435(d)(5)(B) of the HEA prohibits lenders from conducting unsolicited mailings to “students” of loan application forms. And section 435(d)(5)(C) of the HEA prohibits lenders from offering FFEL loans to a “prospective borrower” to purchase an insurance policy.
Indeed, throughout Part B of Title IV of the HEA, which are the provisions governing FFEL, the term “individual” is universally used to mean “human being.” See 20 U.S.C. §§ 1077(a)(2)(C)(f)(II) (“individuals with disabilities”), 1078(b)(1)(M)(i)(II) (“disabled individuals”), 1078-3(a)(3)(B)(i) (“individual’s status as an eligible borrower”; “an individual who receives eligible student loans”; “an individual may obtain a subsequent consolidation loan”), 1078-3(c)(2)(A) (“amount outstanding on other student loans to the individual”), 1078-10(a) (“It is the purpose of this section to encourage individuals to enter and continue in the teaching profession.”), 1078-10(g)(3) (“An individual who is employed as a teacher in a private school”), 1078-11(a)(1) (“to bring more highly trained individuals into the early child care profession”), 1078-11(b)(2) (“an individual who has a degree in early childhood education”), 1078-11(f) (“Each eligible individual desiring loan repayment”; “An eligible individual may apply for loan repayment”), 1078-11(g)(3) (“determine the number of individuals who were encouraged by the demonstration program assisted under this section to pursue early childhood education”; “determine the number of individuals who remain employed”; “identify the number of individuals participating in the program who received an associate’s degree and the number of such individuals who received a bachelor’s degree”; “identify the number of years each individual participates in the program”), 1082(p) (“eligibility of any entity or individual”; “financial interest which such individual may hold in any other entity participating in any program”), and 1085(m)(2)(B) (“A loan on which a payment is made by the school, such school’s owner, agent, contractor, employee, or any other entity or individual affiliated with such school”).

Even more, to conclude that “individual” encompasses legal entities in the same manner as the term “person” would render superfluous the term “educational institution” within the statutory prohibition. If “individual” is broad enough to include a catch-all category of legal entities, then the Congress would not have also included “educational institutions” as a covered class of recipients. The inclusion of “educational institutions” would be unnecessary and, therefore, rendered “superfluous, void, and insignificant,” a statutory construction that the courts disfavor. Alaska Dep’t of Environment Conservation v. EPA, 540 U.S. 461, 489 n.13 (2004) (holding that courts disfavor rendering statutory provisions superfluous).

The proper reading of section 435(d)(5)(A) of the HEA, which is compelled by the plain language of that provision, is that the inducement prohibition only covers payments made to educational institutions or human beings. See MCI Telecommunications Corp. v. AT&T, 512 U.S. 218, 229 (1994) (“[A]n agency’s interpretation of a statute is not entitled to deference when it goes beyond the meaning that the statute can bear.”). The Selling Lenders are neither.6

---

6 The legislative history of the inducement prohibition is consistent with reading the plain language of the HEA to only cover payments made to educational institutions and human beings. The Senate Report of the Committee on Education and Labor states that “[t]he Committee bill clarifies that no lenders can offer inducements to institutions or individuals to take out loans or to provide services unrelated to loans, such as insurance policies.” S. Rep. No. 99-296, at 30 (1986). In that context, “individuals” must mean “human beings” because only human beings can take out FFEL loans and the HEA’s prohibition regarding the offering of insurance policies only relates to a “prospective borrower.” The House Committee Report notes that the enactment of the anti-inducement provision reflected a concern over commissioned salespeople catering directly to students or parents. See H.R. Rep. No. 99-383, at 37 (1985). Clearly, then, the concern of Congress was that lenders could influence the decisions of student and parent
2. The OIG’s finding cannot rely upon the HEA’s general authority to promulgate regulations governing FFEL to justify expanding the HEA’s scope of recipients beyond “any educational institution or individual.”

The Department cannot avoid the HEA’s clear and unambiguous language limiting the scope of inducement recipients to “any educational institution or individual” by relying upon regulations that were issued pursuant to the HEA’s general grant of authority to promulgate regulations governing FFEL. Even where a statute grants an agency general authority to promulgate regulations, agency actions that rely for their justification upon regulations that go beyond the literal words of a clear and unambiguous statute are improper and will be struck as invalid. The Department, then, is prohibited from taking agency action in reliance upon a regulation that is not consistent with the HEA notwithstanding the HEA’s general grant of rulemaking authority.

When a statute contains a general grant of authority and a specific grant of authority, courts look to the specific grant of authority to discern the limit of the agency’s powers. See Varity Corp. v. Howe, 516 U.S. 489, 511 (1996) (stating that “the specific governs over the general”); see also Radzanower v. Touche Ross & Co., 426 U.S. 148, 153 (1976) (“[A] statute dealing with a narrow, precise and specific subject is not submerged by a later enacted statute covering a more generalized spectrum.”); Morton v. Mancari, 417 U.S. 535, 550-51 (1974) (“[A] specific statute will not be controlled or nullified by a general one.”). In Cohn v. Federal Bureau of Prisons, 302 F. Supp.2d 267 (S.D.N.Y. 2004), the court held that a specific provision governing the maximum time to be spent at an early release program took precedence over a more general grant of authority to the Federal Bureau of Prisons to administer such a program, and, therefore, bound the agency to adhere to the more specific provision.

The language of the Department’s anti-inducement regulation is the same as the language of the HEA’s anti-inducement provision except that it uses different terms to describe the scope of covered recipients. Whereas the HEA uses the terms “educational institution” and “individual,” the regulation uses the terms “school” and “other party.” Compare HEA § 435(d)(5)(A), 20 U.S.C. § 1085(d)(5)(A), with 34 CFR § 682.200(b) (definition of “Lender”). On its face, the term “other party” is all-encompassing and, therefore, makes the regulation much more restrictive than the HEA, just as the regulation in Sandler was more restrictive than the HEA.borrowers by paying off schools and financial aid administrators, if not the student and parent borrowers themselves. Nowhere in the legislative history is there even a suggestion that the Congress intended the inducement prohibition to cover payments offered to a type of entity other than educational institutions and human beings.

7 In the Sandler case, which rejected the Department’s reliance upon a regulation as inconsistent with the plain language of the HEA, the court noted the HEA’s general grant of rulemaking authority relating to FFEL. See Sandler, 2001 WL 884552, at *1 (quoting HEA § 432(a)(1), 20 U.S.C. § 1082(a)(1)). Thus, the court implicitly rejected the proposition that the HEA’s general grant of authority to promulgate FFEL regulations permitted the Department to invoke a regulation to deny borrower benefits under circumstances in which such benefits were authorized by the plain language of the HEA. Id. at *1-2.
Therefore, to the extent the OIG’s finding rests upon the Selling Lenders falling into the category of “other party” within the anti-inducement regulation, the finding is improper. Section 435(d)(5)(A) of the HEA specifically addresses the issue of inducements, including the scope of covered recipients. The term “other party” in the Department’s regulation, then, cannot be invoked by the OIG to find the payments made by SLX to the Selling Lenders to be payments made to a prohibited recipient -- section 435(d)(5)(A) of the HEA would not prohibit those payments. Despite the HEA’s general grant of authority to issue regulations under FFEL, see HEA § 432(a)(1), 20 U.S.C. § 1082(a)(1) (authorizing the Secretary to “prescribe such regulations as may be necessary to carry out the purposes of [FFEL]”), the Department is legally precluded from taking administrative enforcement action under the HEA’s anti-inducement provision to the extent the action is taken in connection with payments made to a recipient other than an educational institution or individual, i.e., the statutory language. Again, the Selling Lenders are neither.

***

The payments made by SLX to the Selling Lenders were permissible, and the OIG lacks a sufficient legal and policy basis to make a finding of non-compliance.

Comments on the Recommendations

A. Recommendation 1.1 Is Moot

Recommendation 1.1 merely seeks to have the Department perform internal paperwork (1) terminating the agreement with the Department signed by Fifth Third on behalf of the Selling Lenders, and (2) deactivating the lender identification numbers that were obtained to enable the Selling Lenders to originate loans pursuant to their ELT agreements with Fifth Third. The Draft Audit Report notes that Fifth Third informed the OIG in February 2008 that Fifth Third had already terminated two of its ELT agreements with the Selling Lenders and had so informed the Department and the applicable guaranty agencies that they should terminate the necessary agreements and deactivate the LIDs. See Draft Audit Report, at 7. Fifth Third has now terminated the remaining ELT agreement at issue. Thus, Recommendation 1.1 is moot.

B. Fifth Third Disagrees with Recommendation 1.2 Because it is Disproportionate to the Alleged Offenses and Adverse to the Best Interests of Both Market Participants and Borrowers

1. The termination of federal loan guarantees and the demand for repayment of over $350 million have the potential to cause extreme disruption to the credit markets

Just as the credit markets are attempting to recover from significant, widespread disruptions triggered initially by subprime mortgages, the OIG’s recommendation would inject a major new source of risk and uncertainty for current and potential investors in securities backed by FFEL loans, as well as for student and parent borrowers. The marketplace would likely perceive the OIG’s recommendation to terminate the federal guarantee covering over $3 billion of outstanding FFEL loans as a significant threat to the viability of the guarantee on those student loans and, thus, an indication that those loans do not have as much value as investors believed.
During a period when the credit markets are highly disrupted, the OIG would effectively be preventing SLX from using over $3 billion of student loans to obtain financing that it could then redeploy in other financing activities. The OIG, thus, risks undoing the Department’s recent work to create liquidity in the marketplace.

The marketplace would also likely interpret the OIG recommendation to terminate the federal guarantee -- and the proposal to disregard the form of the transactions among Fifth Third, the Selling Lenders, and SLX -- as a potential threat to the entire multi-billion dollar student loan securitization market. If investors perceive that the guarantee on FFEL loans will be invalidated for alleged errors by an ELT in the origination and marketing process, the uncertainty of the value of such assets could cause a major disruption in the credit markets involving billions of dollars in student loans. See Windsor Univ. v. Secretary of Health, Education, and Welfare, 550 F.2d 1203, 1204-05 (9th Cir. 1977) (“The success of [FFEL] is dependent upon private lenders’ confidence in the guarantees that the federal government provides when it insures their loans to needy students.”). Invalidating a loan guarantee after the FFEL loan has been transferred to a trust estate in which bondholders or noteholders have invested has typically been the result of servicing errors and other acts or omissions that could cause the loan to be deemed invalid or unenforceable. A prohibited inducement payment by a lender justifies a demand from the Department that the offending conduct immediately cease or else risk a loss of eligibility. It does not justify harming innocent investors who purchased securities backed by FFEL loans or harming students who may no longer be able to quickly access a FFEL loan.

The asset backed securities market for FFEL loans, which Fifth Third estimates at $65 billion in 2006, declined to less than $50 billion in 2007 due to disruption in the overall credit market following the onset of the subprime mortgage crisis. The market disruption has adversely impacted the sales prices for FFEL loans and securities backed by FFEL loans. The market for securities backed by such loans appears to have stabilized recently, but it has not returned to 2006 levels. If the OIG’s recommendations exacerbate the existing market disruptions, the ability of investors to sell FFEL loans or securities backed by FFEL loans, and the value of those loans and securities, will be significantly diminished. No investor will know for sure whether its securities are backed by student loans that were originated pursuant to the same type of transaction challenged by the Draft Audit Report.

Furthermore, investor uncertainty as to whether the OIG’s reasoning could be extended to cover other acts or omissions will undermine the market for securities backed by student loans and may cause the market in student loan bonds and notes to rapidly decline. This will irreparably harm not only large financial institutions that originate FFEL loans, but also the nonprofit student loan issuers. If FFEL loans cannot be securitized, which cannot easily be done without a federal guarantee on the loans, then these nonprofit issuers will no longer be viable and there will be insufficient funds available to students, who will suffer the most harm.

Similarly, OIG’s recommendation that Fifth Third reimburse the Department for amounts paid for default claims, interest, and special allowances -- which would be well over $350 million -- will be a jolt to the student lending community that is already hindered by severe liquidity deficiencies. Demanding reimbursement at this level of magnitude is disproportionate to the alleged offenses and will be highly disruptive to the markets. The Draft Audit Report’s recommendation to require Fifth Third to repay these funds will serve primarily as a penalty against students and innocent investors, not as a remedy for the alleged inducements.
2. The Regulations Set Forth Procedures for the Department to Address Alleged Non-Compliance with the Prohibition Against Inducements

a. Lender compliance with the prohibition against inducements is a condition for maintaining status as an “eligible lender” under FFEL and is most appropriately addressed through the regulatory provisions governing limitation, suspension, and termination proceedings.

A lender’s failure to comply with the HEA’s prohibition against inducements threatens its status as an “eligible lender” under FFEL and, therefore, its eligibility to continue to make federally guaranteed student loans. The statutory provision that conditions a lender’s eligibility on its compliance with the inducement prohibition also affords the lender prior notice and an opportunity for a hearing before the Department can remove the lender from the program. See HEA § 435(d)(5)(A); 20 U.S.C. § 1085(d)(5)(A). Thus, the logical framework for adjudicating an alleged inducement is the notice and hearing procedures contained within the limitation, suspension, and termination provisions of 34 CFR part 682, subpart G. See 34 CFR §§ 682.700 et seq. Those provisions provide the most appropriate means for the Department to afford a lender the HEA’s required procedural protections in connection with a proceeding to limit, suspend, or terminate a lender’s eligibility (“L, S, and T proceedings”). In fact, although L, S, and T proceedings do not typically apply to lender eligibility determinations, there is an exception for determinations of whether a lender is ineligible on account of making a prohibited inducement payment. See 34 CFR § 682.700(b)(1)(i) (“This subpart does not apply -- (1)(i) To a determination that an organization fails to meet the definition of ‘eligible lender’ in section 435(d)(1) of the [HEA] or the definition of ‘lender’ in § 682.200, for any reason other than a violation of the prohibitions in section 435(d)(5) of the [HEA].”) (Emphasis added).

Pursuant to the provisions relating to L, S, and T proceedings, the Department has the discretion to commence (as the name suggests) different types of proceedings, or, as discussed below, no formal proceedings at all. For example, the Department may begin a limitation proceeding to condition the lender’s continued participation to FFEL on compliance with special requirements set forth within an agreement with the Department. See 34 CFR § 682.701. This is the course of action the Department took against Sallie Mae in The Scholl College Case. A suspension proceeding, on the other hand, would seek to remove the lender’s eligibility for a specified period of time or until the lender fulfills certain requirements. Id. And a termination proceeding would seek to remove the lender’s eligibility indefinitely. Id. The Department also has the option to use informal compliance procedures, which require no formal proceedings at all.
The Department should not seek a termination of the guarantee on the loans at issue nor, under these circumstances, a repayment of funds

The Draft Audit Report recommends that the Department terminate the guarantee on the over $3 billion of outstanding loans originated by the Selling Lenders and additionally recover from Fifth Third claim payments, interest, and special allowances associated with those loans. With one exception, the L, S, and T proceedings described above cannot result in those remedies because those proceedings cannot “affect a lender’s responsibilities or rights to benefits and claim payments that are based on the lender’s prior participation in [FFEL].” 34 CFR § 682.702(a). The exception to the rule does not permit the termination of loan guarantees at all and would not permit a repayment of funds under the circumstances of this case.

The exception to the rule permits the Department, as part of a limitation or termination proceeding, to require the lender to take corrective action in the form of a payment to the Department of any funds, and any interest thereon, that the lender improperly received. See 34 CFR § 682.709(b). Such a payment must, however, be “reasonable” and be imposed in order to “remedy a violation” of the HEA and its regulations. See 34 CFR § 682.709(a). Thus, the Department should not terminate the guarantee of the loans in question, and the repayment of funds, in this case, would not be authorized because it would be neither reasonable nor remedial. Fifth Third estimates that over $350 million in claim payments, interest, and special allowances on the loans have been received, which is hardly a “reasonable” amount to repay the Department. Additionally, repayment of that amount of funds by Fifth Third would not “remedy” its alleged violation of the HEA’s anti-inducement provision. The true remedy for such a transgression would be an immediate cessation of the prohibited conduct, which is the remedy the Department traditionally seeks for non-compliance with the inducement prohibition. Under these circumstances, repayment would be punitive, not remedial.

The Department may use informal compliance procedures in lieu of commencing a limitation, suspension, or termination proceeding

Importantly, the same provisions governing L, S, and T proceedings that the Department uses to address alleged prohibited inducements also expressly authorize the Department to use informal compliance procedures in lieu of commencing a limitation, suspension, or termination proceeding. See 34 CFR § 682.703(a). Informal compliance procedures would be especially appropriate where, as here, the lender can “[s]how that the alleged violation has been corrected” or can at least “submit an acceptable plan for correcting the alleged violation and preventing its recurrence.” 34 CFR § 682.703(b)(2).

Under the informal compliance procedures, the Department provides the lender a “reasonable opportunity” to respond to the allegations and to make its showing of the corrective measures it has taken or its submission of a corrective action plan. 34 CFR § 682.703(b)(1). There is no reason to terminate the guarantee on the loans at issue, or to require the lender to reimburse the Department for over $350 million in claim payments, interest, and special allowances. As described more fully below, the Department has, in the recent past, successfully employed informal compliance procedures to address non-compliance with the prohibition against inducements. Yet the Draft Audit Report does not mention that this is even an option for the Department, let alone the most appropriate option here and the most used option by the
Department in the recent past. The OIG’s recommendations should be revised to recommend informal compliance procedures.

The Department may additionally commence a fine proceeding

In addition to the informal compliance procedures described above, the Department may, in its discretion, also impose a civil penalty (a fine) against a lender for failing to comply with a provision of the HEA. See HEA § 432(g)(1); 20 U.S.C. § 1082(g)(1). Such a fine proceeding would also require adherence to provisions containing procedures for prior notice and an opportunity for a hearing. See id. Following the procedures prescribed in 34 CFR part 668, subpart G applicable to fine proceedings against schools, as the Department must do for fine proceedings against lenders, see 34 CFR § 682.413(d)(1), the Department may impose a fine of up to $27,500 per violation. See 34 CFR § 682.84(a).

The HEA, however, provides several broad limitations upon the Department’s authority to impose a fine. The Department must first find that the violation is “material.” HEA § 432(g)(2)(A); 20 U.S.C. § 1082(g)(2)(A). Second, the Department must find that the lender “knew or should have known that its actions violated or failed to carry out the [FFEL provisions of the HEA] or the regulations thereunder.” HEA § 432(g)(2)(B); 20 U.S.C. § 1082(g)(2)(B). Third, the Department cannot impose a fine if, prior to the notification by the Department of the fine proceeding, the lender “cures or corrects the violation.” HEA § 432(g)(3); 20 U.S.C. § 1082(g)(3). And fourth, violations arising from a specific practice of a lender, and occurring prior to notification by the Department, shall be deemed to be a single violation, even if the violation affects more than one loan or more than one borrower, or both. See HEA § 432(g)(4); 20 U.S.C. § 1082(g)(4). The Draft Audit Report did not, however, mention that this is even an option for the Department, let alone analyze the applicability of a fine proceeding.

b. The authorities cited within the Draft Audit Report do not provide the Department an adequate legal basis to take the action recommended by the OIG

In support of its legal basis for the recommendations, the Draft Audit Report cites to regulations that the Department does not use to address non-compliance with the inducement prohibition. See Draft Audit Report, at 7 (citing 34 CFR §§ 682.406(a)(12) and 682.413(a)(1)). As discussed above, the statutory inducement prohibition requires prior notice and an opportunity for a hearing before a lender loses its eligibility to participate in FFEL. The Department’s regulations governing the limitation, suspension, or termination of eligible lenders provide such procedural protections. See 34 CFR §§ 682.700 et seq. Not only should the L, S, and T regulations be used to adjudicate alleged inducement payments, they must be used because the Department expressly states that they are the regulations that apply to determinations of whether a lender has failed to comply with the prohibition against inducements. See 34 CFR § 682.700(b)(1)(i). Thus, the Department’s regulations governing L, S, and T proceedings -- and not the regulations cited by the OIG -- are the appropriate regulations for the Department to use.8

---

8 To be sure, the regulations cited by the OIG are not superfluous or unnecessary. They are important provisions that, to some extent, tie the FFEL program together by setting some important conditions for the payment of reinsurance. But those generally applicable regulations must yield to the specific regulatory provisions that are used to determine whether a lender has
The OIG's citation of section 682.406(a)(12) is even less persuasive to support a recommendation that the Department must terminate the guarantee on the over $3 billion of outstanding loans when it is read together with paragraph (b) of that section. Paragraph (b) provides that the Department may choose to waive its right to deny a reinsurance payment to a guaranty agency if it is in the best interests of the United States to do so:

(b) Notwithstanding paragraph (a) of this section [providing that a guaranty agency may make a claim payment and receive a reinsurance payment on a loan only if certain requirements are met], the Secretary may waive his right to refuse to make or require repayment of a reinsurance payment if, in the Secretary's judgment, the best interests of the United States so require.

34 CFR § 682.406(b) (emphasis added). As discussed more fully above, the best interests of the United States at this moment in time quite obviously tip the scales in favor of the Department waiving any right it may have to refuse to make or require repayment of a reinsurance payment. Any refusal by the Department to make reinsurance payments to the applicable guaranty agencies on the over $3 billion of outstanding loans would necessarily cause those guaranty agencies to refuse to honor the guarantee on those loans. The resulting significant devaluation of securities backed by these student loans and the subsequent further inability of lenders to successfully securitize student loans going forward would likely create disruption in the financial markets and lead to an even greater decrease in the number of lenders willing to make FFEL loans.9

3. The Department has not terminated loan guarantees or required repayment of funds for non-compliance with the inducement prohibition

Since at least 1994, with one notable exception, it has been the Department’s policy to use informal compliance procedures to resolve allegations of improper inducements.10 As a result, the Department has never terminated the guarantee on loans alleged to have been originated in connection with an inducement payment, and the Department has never required lenders to reimburse the Department for claim payments, interest, and special allowances. Even when the OIG, in 2003, purported to uncover a prohibited inducement payment made by Sallie Mae, the Department merely issued a Final Rule that, effective July 1, 2008, amends section 682.406 of the FFEL regulations to expressly require the termination of the loan guarantee following a finding of an inducement. See 72 Fed. Reg. 61960, 62006 (Nov. 1, 2007) (new 34 CFR § 682.406(d)). Until this regulation becomes effective, the Department does not have a regulation that expressly requires the termination of the federal guarantee upon a finding of a prohibited inducement.

Transgressed the prohibition against inducements, which include the types of remedies the Department may seek to recover from the offending lender. See Long Island Care at Home, Ltd. v. Coke, 127 S. Ct. 2339, 2348 (2007) (in statutory and regulatory interpretation, "the specific governs the general").

9 The Department very recently issued a Final Rule that, effective July 1, 2008, amends section 682.406 of the FFEL regulations to expressly require the termination of the loan guarantee following a finding of an inducement. See 72 Fed. Reg. 61960, 62006 (Nov. 1, 2007) (new 34 CFR § 682.406(d)). Until this regulation becomes effective, the Department does not have a regulation that expressly requires the termination of the federal guarantee upon a finding of a prohibited inducement.

10 The one exception was the Department’s unsuccessful attempt, beginning in 1995, to limit the participation of Sallie Mae in FFEL. That enforcement proceeding resulted in a series of administrative decisions and, ultimately, a rebuke of the Department from a federal district court judge in The Scholl College Case.
Mae to a school, the OIG did not recommend that the Department terminate the guarantee on affected loans or seek reimbursement from the lender.

a. The Department uses informal compliance procedures whenever possible to address non-compliance with the prohibition against inducements and, therefore, does not terminate loan guarantees or require repayment of funds.

It is the longstanding policy of the Department to use informal compliance procedures to address non-compliance with the prohibition against inducements. In February 1994, Region IV of the Department asked the Department’s headquarters, in connection with an inquiry regarding an alleged inducement payment discovered during a program review, whether it is the policy of the Department to terminate the guarantee on affected loans. See Department Q&A Document (Feb. 4, 1994) (Exhibit 1, attached hereto). In the scenario presented by Region IV, a secondary market lender paid for loan referrals. A response from Robert Evans, Director, Division of Policy Development, informed Region IV that the lender’s conduct failed to comply with the prohibition against inducements but that the Department should use informal compliance procedures to address the transgression and should not refuse to make reinsurance payments on the loans:

We do not believe that this violation warrants a voiding of reinsurance or restriction of interest and special allowance on loans previously disbursed under the referral program. Instead, the lender should be cited and instructed to restructure its referral program by a specified deadline if it wishes to continue it. The Department should require submission of some evidence (letter of assurance from the Chief Executive Officer or revised policies and procedures) that supports the fact that they have discontinued or revised the program. The lender should be told that its failure to comply will result in its ineligibility as a lender in the FFEL program.

Department Q&A Document (Feb. 4, 1994) (emphasis added).

More recently, the Department has continued to use informal compliance procedures to resolve alleged inducements. As reported last year by the GAO, “When Education does respond to instances of non-compliance, the department has commonly sent letters to offending parties noting the prohibited activity and requesting they cease the activity, but has not imposed sanctions.” GAO-07-750, at 37 (July 2007). In its report, the GAO listed the Department’s most recent inducement-related activities, all of which were consistent with the Department’s use of informal compliance procedures:

- For two lenders that were found offering rebates to loan applicants, Education sent letters asking them to cease the activity and to return pending applications to applicants.

- For one school that was denying its students the ability to take loans from a particular lender, Education sent a letter requesting that the school cease the activity.
• Education plans to send a letter to lenders offering gift cards or music players to borrowers who complete loans with them.

Id.

In its response to the GAO report, the Department stated that it leaves open the option to impose fines and to initiate L, S, and T proceedings for alleged inducements, but that, with respect to the school cited in October 2006 for an alleged inducement, the Department had successfully used informal compliance procedures to address and remedy the situation:

As part of our current review procedures, schools, lenders, and guaranty agencies are required to submit evidence that any non-compliance was corrected or to establish a corrective action plan, which we then verify. For example, the school cited for non-compliance in the October 2006 targeted review submitted a corrective action plan to the Department. We then verified the corrective action by reviewing the school’s revisions to its Web site clarifying “borrower choice.”

Id. at 46-47 (emphasis added).

Earlier this year, the Department again used informal compliance procedures to address non-compliance with the prohibition against inducements. See Letter from P. Trubia to Deutsche Bank and Academic Loan Group, LLC (Jan. 18, 2008) (“ALG Letter”) (attached hereto as Exhibit 2). In its January 18, 2008 letter to a lender and its ELT, the Department purported to clarify the entities’ obligations to comply with the anti-inducement provisions that had been addressed in an earlier letter, which the Department attached. In both letters, the Department addressed the situation by ordering the offending lender to immediately terminate its wrongful conduct:

I want to clarify that in order to comply with the anti-inducement provisions of 20 U.S.C. § 1085(d)(5)(A), these rebates [to FFEL borrowers following a payment made by them to repay their Federal Consolidation Loans] cannot be paid directly to the borrower in the form of a check or cash.

ALG must immediately cease and desist from providing rebates in the form of checks or cash to its borrowers.

ALG Letter, at 1 (emphasis added).11

Therefore, the Department has an established practice of using informal compliance procedures whenever possible and has not terminated the loan guarantee or required repayment

11 In an even more recent example, the Department used informal compliance procedures in ordering an ELT to cease and desist its actions that the Department alleged were in violation of the HEA’s related prohibition against unsolicited mailings. See HEA § 435(d)(5)(B); 20 U.S.C. § 1085(d)(5)(B). The Department threatened to commence L, S, and T proceedings only if the offending conduct did not immediately cease, and the Department required the ELT to confirm the corrective actions that the ELT has taken to address the matter. See Letter from P. Trubia to US Bancorp (Apr. 21, 2008) (attached hereto as Exhibit 3).
of funds for non-compliance with the inducement prohibition. Like the other lenders with which
the Department previously worked to forge a corrective action plan, Fifth Third would work with
the Department to remedy the alleged inducement. In fact, Fifth Third has already terminated
the very ELT arrangements challenged in the Draft Audit Report.

b. The OIG did not recommend the termination of loan guarantees or
the repayment of funds when it purported to have uncovered a
prohibited inducement in 2003

In August 2003, the OIG issued an Alert Memorandum to the Assistant Secretary for the
Office of Postsecondary Education, in which the OIG reviewed the issue of prohibited
inducements. See Alert Memorandum from C. Lewis to S. Stroup (Aug. 1, 2003) (“OIG Alert
Memorandum”) (attached hereto as Exhibit 4). In its memorandum, the OIG lamented the
Department’s lack of formal guidance to the student lending community, the inadequacy of
providing informal guidance in letters and e-mails, and the paucity of administrative reviews and
enforcement actions. See id. at 1. The OIG concluded that the Department should provide
formal guidance clarifying the application of the HEA’s anti-inducement provision to private
loans and determine whether statutory changes should be proposed. See id. at 2.

Notably, the OIG informed the Department that it had come to this conclusion following
the OIG’s own review of the practices at two schools. See OIG Alert Memorandum, at 2. The
OIG selected two schools for review based on an increase in loan volume for Sallie Mae and
purported to uncover that lenders, generally, provided benefits to schools in exchange for
favorable treatment by the schools that could lead to the referral of loan applications: “We found
evidence that one of these schools and Sallie Mae negotiated preferred lender status in exchange
for a specified dollar amount of private loans.” Id. (Emphasis added). Rather than
recommending the termination of the loan guarantees and the reimbursement of funds (or any
sanction at all), the OIG merely suggested that the Department consider making regulatory
changes or providing further guidance. Id.
FINDING NO. 2 -- Fifth Third Bank’s Policies and Procedures for Monitoring its ELT Agreements Need To Be Improved

Comments on the Finding

Compliance with the HEA

The Draft Audit Report’s finding, to the extent it is premised upon alleged non-compliance with the HEA, is not legally sound. The OIG takes the HEA’s requirement that ELTs be responsible for complying with all statutory and regulatory requirements imposed on any FFEL holder, see HEA § 436(b), 20 U.S.C. § 1086(b), and finds that it was violated because Fifth Third allegedly did not “maintain records that are necessary to document the validity of claims and the accuracy of reports [submitted to the Department and guaranty agencies].” 34 CFR § 682.414(a)(4)(ii)(L).

The OIG contends that Fifth Third “did not have written policies and procedures . . . for the evaluation of entities for potential ELT agreements and the monitoring of existing ELT agreements . . . , including policies and procedures to ensure that the agreements do not include or result in payment of prohibited incentives. . . .” Draft Audit Report, at 8. The OIG makes that finding in belief that having such written policies and procedures would necessarily satisfy the regulatory requirement that Fifth Third “maintain records that are necessary to document the validity of claims and the accuracy of reports [submitted to the Department and guaranty agencies].”

However, written policies and procedures for (1) the evaluation of entities for potential ELT agreements and (2) the monitoring of existing ELT agreements do not relate to the requirement that lenders document the validity of claims and the accuracy of reports. Such documentation tasks would likely be performed by the ELT’s lender partner. To be sure, the ELT would be responsible for the lender partner’s compliance with those documentation requirements. But an ELT cannot be cited for failing to maintain records that are necessary to document the validity of claims and the accuracy of reports on the basis of not having written policies and procedures for the evaluation of potential lender partners and for the monitoring of those lenders. The OIG’s finding does not link the two concepts, and it cites no legal authority to support its linkage.

Fifth Third, therefore, disagrees with the finding to the extent it is premised upon alleged non-compliance with the HEA. The OIG has no valid legal basis.

Compliance with Standards of the Office of the Comptroller of the Currency

The Draft Audit Report’s finding is additionally based on the OIG’s application of the Safety and Soundness Standards set forth by the Office of the Comptroller of the Currency at the U.S. Department of the Treasury, as well as the Comptroller’s Handbook on Internal Controls published by the Comptroller of the Currency Administrator of National Banks. See Draft Audit Report, at 8-9. To begin, the OIG does not appear to have statutory authority to make findings that allege transgressions of Treasury Department standards or handbooks. Under the HEA, the OIG only has legal authority to conduct audits of lenders to assess compliance with federal
statutes and with rules and regulations of the U.S. Department of Education, not with those of other federal departments and agencies:

(4) AUDIT PROCEDURES. — In conducting audits pursuant to this subsection, . . . the Inspector General of the Department of Education shall audit the records to determine the extent to which they, at a minimum, comply with Federal statutes, and rules and regulations prescribed by the Secretary, in effect at the time that the record was made. . . .

HEA § 432(f)(4); 20 U.S.C. § 1082(f)(4) (emphasis added). The OIG, therefore, lacks legal authority to make a finding on the basis of Treasury Department standards and handbooks.

Assuming arguendo that the OIG possesses the requisite legal authority to make a finding under Treasury Department standards and handbooks, its finding is hyper-technical at best, and, at worst, legally unsupportable. The OIG discerns a few important, though subjectively worded, requirements from those Treasury Department banking authorities and concludes that, despite Fifth Third’s explanation for its compliance with those authorities, Fifth Third has nonetheless fallen short of the Treasury Department’s expectations. See Draft Audit Report, at 9-10.

With respect to the finding that Fifth Third lacked adequate written policies and procedures for the evaluation of entities for potential ELT agreements, the Treasury Department standards that are most relevant are “[e]ffective risk assessment” and “[a]dequate procedures to safeguard and manage assets.” Draft Audit Report, at 9. OIG concedes that Fifth Third’s Vice President for the Asset Securitization Department advised that he evaluates potential ELT lender partners and the proposed arrangements prior to entering into an ELT agreement. See id. at 9-10. The OIG notes that Fifth Third’s Vice President listed six elements that Fifth Third uses to determine whether it will enter into an ELT agreement with a lender:

- Industry experience and management;
- Student loan origination and servicing arrangements;
- Funding commitments;
- Student loan sale and purchase commitments;
- Student loan processes and systems; and
- Financial strength.

Id. at 9. Furthermore, Fifth Third’s Vice President, or one of two other bank officials (if not a manager from a branch office), conducts a site visit to interview the prospective lender partner to assess its expertise in the student loan industry and its business practices, to review the financial statements, and to discuss the lender’s loan servicer and purchaser arrangements. Id.

Despite these responsible measures, the OIG finds nothing about which to praise Fifth Third in connection with its commendable efforts to evaluate entities for potential ELT
agreements. Instead, it finds something minor about which to criticize Fifth Third: “The Vice President maintained some documents related to initial assessments . . . but could not identify the documents related to each ELT agreement.” Draft Audit Report, at 10. And from that relatively insignificant shortfall, the OIG reaches the most serious of conclusions: “Without sufficient written procedures and complete documentation of evaluations, there is a lack of assurance that Fifth Third Bank is adequately evaluating entities and their relationships with third parties in a thorough and consistent manner.” Id. The OIG’s finding should not be part of a Final Audit Report because it is unsupported by the record.

As for the OIG’s finding that Fifth Third did not have written policies and procedures for the monitoring of existing ELT agreements, including policies and procedures to ensure that the agreements do not include or result in payment of prohibited incentives, Fifth Third had an even greater list of actions it takes to ensure that its lender partners comply with applicable legal requirements. But, again, the OIG finds that Fifth Third’s efforts fall short of Treasury Department standards. In addition to the two Treasury standards described above, the remaining three standards are arguably applicable to Fifth Third’s monitoring responsibility: (1) An organizational structure that establishes clear lines of authority and responsibility for monitoring adherence to established policies; (2) Timely and accurate financial, operational, and regulatory reports; and (3) Compliance with applicable laws and regulations. See Draft Audit Report, at 9.

Fifth Third’s Vice President presented the OIG with a long list of actions it takes to monitor its ELT agreements with lenders. As noted in the Draft Audit Report, he informed the OIG that Fifth Third:

- Reviews monthly loan activity for entities with low loan volume;
- Reviews annual financial statements;
- Reviews the bill of sale for all secondary loan sales;
- Maintains continuous contact with relationship manager or other Fifth Third Bank managers that conduct due diligence for their services with the entity;
- Establishes ongoing business relationships with lenders and companies in the industry;
- Studies the publications for the industry;
- Reviews guaranty agency reports on loan servicers;
- Reviews annual marketing and origination process reviews for SLX agreements; and
- Attends student loan conferences.
Draft Audit Report, at 10. In addition, Fifth Third reviews guaranty agency reports “to ensure that the lenders and servicers are processing loans in accordance with Federal laws and regulations.” Id.

The OIG again gives Fifth Third no credit for having these important safeguards in place to ensure a high level of monitoring, even though each one of them furthers the Treasury Department’s standards. Instead, the OIG criticizes Fifth Third for perceived, minor shortfalls. For example, the OIG notes that Fifth Third “did not have a process to ensure that it received all pertinent reports from the guaranty agencies.” Draft Audit Report, at 10 (emphasis added). The OIG also notes that Fifth Third does not mention whether it reviews “the annual independent public accountant audit reports that are required for lenders and loan servicers.” Id.

Just as it did in connection with its finding relating to the evaluation of potential ELT lender partners, the OIG reaches an overstated conclusion from the facts relating to Fifth Third’s monitoring activities:

[T]here is a lack of assurance that Fifth Third Bank is performing sufficient monitoring of entities with which it as ELT agreements to ensure that the entities adhered to applicable requirements of the FFEL Program, including the prohibition on offering incentives to secure loan applications.

Id. The OIG’s finding on this issue should also not be part of a Final Audit Report. Again, the record simply does not support the finding.

Comments on the Recommendations

The Draft Audit Report recommends that Fifth Third (1) create written procedures to document how it performs thorough evaluations of potential ELT lender partners and how it conducts monitoring of its current ELT relationships, and (2) centrally maintain records related to its evaluation and monitoring activities. Additionally, the OIG recommends that the Department cease taking actions that further any new ELT agreement involving Fifth Third until Fifth Third has completed the other recommended actions.

Each of these recommendations is unnecessary because Fifth Third already uses the recommended procedures and already centrally maintains its records. Fifth Third and the OIG may dispute whether those procedures should be “written” and whether the records are adequately maintained, but the point is moot. Fifth Third has terminated the ELT agreements at issue and the LIDs used to originate FFEL loans made pursuant to those agreements have been deactivated. In addition, Fifth Third is transitioning out of the business of serving as an ELT and does not intend to enter into any new ELT agreements with lenders. For those reasons, Fifth Third disagrees with the recommendations.
OTHER MATTER

Comments on Other Matter

The Draft Audit Report contains a section entitled “Other Matter,” in which the OIG notes that it found other transactions “that include the offering of an incentive.” Draft Audit Report, at 12. The OIG did not, however, include those transactions within its finding of non-compliance because “the ELT agreements differed structurally from the ELT agreements that Fifth Third Bank and SLX had with the [Selling Lenders].” Id. The only difference, structural or otherwise, identified by the OIG is that “Fifth Third Bank’s ELT agreements with the other entities did not name a third party, such as SLX, in the ELT agreement.” Id. Otherwise, the arrangements were the same. Id.

The OIG states that it chose not to include these arrangements within its finding of non-compliance for two reasons. First, “the arrangements are similar in some respects to an example of a permissible practice described in DCL 89-L-129.” Id. And second, “the arrangements are similar in some respects . . . to an arrangement that was the subject of a previous enforcement proceeding undertaken by the Department.” Id. As a result, the OIG determined that, rather than include them within a finding of non-compliance, it would “refer these ELT agreements to the Department for determination of whether the arrangements violate the prohibition on incentives.” Id.

Thus, the OIG reveals in the “Other Matter” section of the Draft Audit Report what it is that the OIG believes to be the only problem with the transactions between SLX and the Selling Lenders: SLX was a party to the ELT agreement between Fifth Third and each Selling Lender. That one fact is the only difference the OIG can identify between the payments in question and the payments that are not in question. The OIG concedes that, without that one fact, the 1989 Dear Colleague Letter and the “previous enforcement proceeding undertaken by the Department,” i.e., the proceeding against Sallie Mae that led to The Scholl College Case, would preclude any finding of non-compliance. As discussed above, Fifth Third’s view is that, even with that fact, there was no transgression of the HEA’s anti-inducement provision.

Fifth Third, therefore, respectfully requests that the OIG not include this “Other Matter” section in any Final Audit Report.
EXHIBIT 1
Question and Answer

Names: Barbara G
Region: IV

Date: February 4, 1994
Phone: 5629
TO signoff: [Blank]

Question Relates to an Open Program Review: [Yes]

Q: (State question and attach background info only if necessary.)

Reference: U.S.A. §620(2)(d)(2); DCL §9-L-129; February 1989; Q & A #3 3/20 1989; Q & A #933 6/2/3; and Q & A #977 9/13/93

The Tennessee secondary market, Volunteer State Student Funding Corp (VSSFC), pays lenders in the State of Tennessee a marketing fee of 1/2 percent of the principal balance of any loan originated by VSSFC which was funded as a result of the lender's referral. If a first disbursement is made and subsequently cancelled, VSSFC still pays the referring lender a marketing fee on that disbursement. If the second or subsequent disbursement is cancelled prior to being disursed, or if an application is processed but never funded, no marketing fee is paid. VSSFC pays a flat $75 referral fee for each consolidation loan. This $75 equates to 1/2 percent of their average consolidation loan.

(continued on page 2)

A: (Cite appropriate regulation, if applicable.)

PLEASE SEE ATTACHMENT

For FOS Use: Date rec'd by DPPD: Date mailed to RO:
Respondent:

FILE COPY

<table>
<thead>
<tr>
<th>OFFICE</th>
<th>SURNAME</th>
<th>DATE</th>
<th>OFFICE</th>
<th>SURNAME</th>
<th>DATE</th>
</tr>
</thead>
</table>
Based on the references cited, Region IV interprets VSSFC's current practice to be in violation of HBE §485 since the marketing/referral fee is paid only on those loans funded. Is our interpretation correct? If so, would this void the guarantee on all loans funded in this manner and make the lender ineligible for all interest and special allowance paid by the Secretary on these loans?

VSSFC's marketing recommendations for lenders participating in its program are quite extensive, including but not limited to, press releases to local newspapers and radio stations, mass mailings of letters to graduating seniors and parents, statement stuffers, and financial aid workshops and career day meetings for graduating seniors at area high schools. In order to bring VSSFC back into compliance with the law, must VSSFC pay a reasonable marketing/referral fee for all applications processed or for all applications distributed by the referring lender?

ATTACHMENT

A: As stated in Q & A §77, the referral fee must be based on "actual administrative costs incurred in processing the applications and in advertising the availability of loans through the referring lender" (emphasis added). Thus, the fee is based neither on number of applications processed nor on number of applications distributed, but the overall cost associated with both administrative functions. The Department permits the lender[s] involved to determine what a reasonable fee would be for these activities. However, any portion of the fee that exceeds the actual costs associated with processing loan applications or advertising constitutes a prohibited inducement. Also, Region IV is correct in its understanding that the fee must be paid for all loan applications processed, not just those that result in a disbursement of a loan. In order to bring VSSFC back into compliance with the statute, they must pay a reasonable marketing/referral fee for all loan applications processed.

We do not believe that this violation warrants a voiding of reinsurance or restriction of interest and special allowance on loans previously disbursed under the referral program. Instead, the lender should be cited and instructed to restructure its referral program by a specified deadline if it wishes to continue it. The Department should require submission of some evidence (letter of assurance from the Chief Executive Officer or revised policies and procedures) that supports the fact that they have discontinued or revised the program. The lender should be told that its failure to comply will result in its ineligibility as a lender in the FFEL program.

Date

Robert W. Evans
Director, Division of Policy Development and Member, Direct Student Loan Task Force
EXHIBIT 2
January 18, 2008

Mr. Robert F. Frier
Director
Deutsche Bank
25 DeForest Bank
Summit, NJ 07901

Mr. Paul Marble
President
Academic Loan Group, LLC
10935 Vista Sorrento Parkway
Suite 350
San Diego, CA 92130

Dear Mr. Frier and Mr. Marble:

This letter is to clarify guidance provided to your companies in the attached letter, dated March 15, 2006, from Mr. Matteo Fontana of the Department’s Federal Student Aid office. A copy of Mr. Fontana’s letter is enclosed. In his letter, Mr. Fontana addressed Academic Loan Group’s (ALG) practice of providing rebates to borrowers of Federal Family Education Program loans under certain circumstances. Mr. Fontana noted that ALG had taken steps to comply with anti-inducement provisions of 20 U.S.C. §1085(d) (5) (A), by establishing a requirement that to receive a rebate, the borrower must make at least one payment. I want to clarify that in order to comply with the anti-inducement provisions of 20 U.S.C. §1085(d) (5) (A), these rebates cannot be paid directly to the borrower in the form of a check or cash.

ALG must immediately cease and desist from providing rebates in the form of checks or cash to its borrowers.
If you have any questions or comments about the contents of this letter please contact Ann Marie Fusco at (646) 428-3774.

Patricia Trubla
Acting Director
Financial Partner Eligibility & Oversight
Program Compliance
Federal Student Aid
Dear Mr. Frier and Mr. Marble,

The U.S. Department of Education (Department) has reviewed your February 1, 2006 letter regarding your companies' practice of offering applicants for Federal Consolidation Loans a one percent rebate for taking out a consolidation loan under the Family Education Loan Program (FFELP).

Your letter was in response to my letter dated January 19, 2006 to Deutsche Bank, as eligible lender trustee for Academic Loan Group (ALG). My letter notified Deutsche Bank that the Department had reviewed ALG's marketing material and practices and determined that these practices violated the FFELP's prohibition on an eligible lender offering inducements to secure loan applicants. See 20 U.S.C. §1085(d)(5)(A); 34 C.F.R. §682.200(b) ("Lender"). In particular, my letter identified ALG's offer of a one percent cash rebate to Deutsche Bank Consolidation Loan borrowers violated the anti-inducement provision since the rebate was paid solely because the loan was made. My letter outlined certain actions that had to be taken by Deutsche Bank to correct this violation.

Your letter of February 1 constituted the response of Deutsche Bank and ALG to my letter of January 19. Your letter acknowledged that from May to October 2005, your companies had offered rebates to borrowers based solely on the loan being disbursed. However, you indicated that since November 2005, your companies had been requiring borrowers to make a payment to receive the rebate.

Based on the information in your letter, the Department has determined that during the period of May 2005 through October 2005, Deutsche Bank, by reason of this practice, violated the prohibition on inducements in 20 U.S.C. §1085(d)(5)(A) and the Department's regulations by providing a rebate without requiring any payments.
However, because the situation has been corrected and the one loan payment requirement has been reinstated since the beginning of November 2005, the Department has determined that, with the exceptions listed below, no further action is required of Deutsche Bank and ALG.

In your February 1st letter, Deutsche Bank and ALG agreed to take certain steps to address the Department’s concerns regarding the loans made in response to the improper inducement. However, your letter asked the Department to consider certain changes to the specific steps outlined in my January 19th letter. I have addressed each of your requests below:

**Applicants who were not informed of a prior payment requirement applicable to the rebate before applying for a loan from Deutsche Bank as eligible lender trustee for ALG pursuant to the rebate offer.**

ALG may offer these individuals a borrower benefit that the Department views as permissible under the statute or may inform them that the prior payment requirement must be met to receive the one percent rebate.

Instead of immediately returning the applications to the prospective borrowers in this category, ALG may first send a letter as described in section (1.b.) of your February 1st letter informing the individual of their options and notifying the individual that the one percent rebate will only be provided after the borrower makes the first payment on the loan. The letter must be submitted to the Department for approval prior to being sent to the applicants.

ALG must track all applicants in this category and maintain records of each applicant’s written request to proceed with the loan or to withdraw the loan application, and those individuals whose applications are cancelled after 30 days due to no response.

**Applicants who were informed of a prior payment requirement for the rebate before applying for a loan from ALG pursuant to the rebate offer.**

ALG may proceed with processing the applications for borrowers in this category.

**Current status of outstanding loans.**

ALG and associated securitization trusts, through the Trustees, may file claims for interest benefits, special allowance, and claim payment on outstanding loans made pursuant to the rebated offer, and may otherwise treat such loans as fully guaranteed and reinsured for all purposes.

**No adverse administrative action against ALG or the Trustees.**
Assuming satisfactory completion of the steps described above, including validation by the Department’s Financial Partner Services office, the Department will not take any further adverse administrative action against ALG or the Trustee as long as no material misrepresentation of facts have been made or discovered in the course of this matter.

Please continue to use Michael Sutphin, on my staff, at 202-377-3624 as your contact to address your issues or questions.

Sincerely,

Matteo Fontana  
General Manager  
Financial Partner Services  
Federal Student Aid

cc: Theresa S. Shaw, Chief Operating Officer, Federal Student Aid
From: Origin ID: YXIA (202)377-4275
Veronica Greene
Department of Education, FSA
830 First Street, NE -- UCP 3, 61G3
Washington, DC 20002

To: (202)377-4275
Mr. Paul Marble, President
Academic Loan Group, LLC
10935 Vista Sorrento Parkway
Suite 350
San Diego, CA 92130

Bill Sender

MON - 21 JAN
PRIORITY OVERNIGHT

XH-SANA
SAN
CA-US
92130

Shipping Label: Your shipment is complete.
1. Use the 'Print' feature from your browser to send this page to your laser or inkjet printer.
2. Fold the printed page along the horizontal line.
3. Place label in shipping pouch and affix it to your shipment so that the barcode portion of the label can be read and scanned.

Warning: Use only the printed original label for shipping. Using a photocopy of this label for shipping purposes is fraudulent and could result in additional billing charges, along with the cancellation of your FedEx account number.

Use of this system constitutes your agreement to the service conditions in the current FedEx Service Guide, available on fedex.com. FedEx will not be responsible for any claim in excess of $100 per package, whether the result of loss, damage, delay, non-delivery, misdelivery, or misinformation, unless you declare a higher value, pay an additional charge, document your actual loss and file a timely claim. Limitations found in the current FedEx Service Guide apply. Your right to recover from FedEx for any loss, including intrinsic value of the package, loss of sales, income interest, profit, attorney's fees, costs, and other forms of damage, whether direct, incidental, consequential, or special is limited to the greater of $100 or the authorized declared value. Recovery cannot exceed actual documented loss. Maximum for items of extraordinary value is $500, e.g. jewelry, precious metals, negotiable instruments and other items listed in our Service Guide. Written claims must be filed within strict time limits, see current FedEx Service Guide.


1/18/2008
Mr. Richard K. Davis  
President and Chief Executive Officer  
US Bancorp  
800 Nicollet Mall  
Minneapolis, MN 55402  
Re: LID 834240  

Dear Mr. Davis:  

The US Department of Education (the Department) has received information concerning the solicitation of student borrowers for Federal Family Education Loan (FFEL) program consolidation loans by US Bank as Eligible Lender Trustee (ELT) for Collegiate Solutions, lender identification number (LID) 834240. As part of this solicitation, the borrower is sent an application for a Federal Consolidation Loan without having requested one. The borrower is asked to supply the PIN number that is used to identify the borrower in student financial aid related transactions with the Department. Additionally, the borrower is asked to sign the promissory note, but not to provide the signature date.  

US Bank is the ELT for Collegiate Solutions as authorized pursuant to Title IV of the Higher Education Act of 1965, as amended, 20 U.S.C. §§ 1070 et seq. As the ELT, US Bank is the legal holder of FFEL program loans in which other entities hold a beneficial interest. US Bank is fully responsible to the Department under section 436(b) of the Higher Education Act and 34 CFR 662.203 (b) of the FFEL program regulations for ensuring compliance with all statutory and regulatory requirements.  

Section 435(d)(5)(B) of the Higher Education Act of 1965, as amended, states that the term “eligible lender” does not include any lender that, after notice and an opportunity for a hearing, “conducted unsolicited mailings to students of student loan application forms, except to students who have previously received loans from under this part from such lender...”
As part of this solicitation, at the top of page 2 of the unsolicited Federal Consolidation Loan application, the borrower is encouraged to provide his or her PIN data, as indicated in the following text taken directly from the application:

"You can access your federal student loan records on-line, from the National Student Loan Data System, at www.nslds.ed.gov, provided you have a PIN number that the U.S. Department of Education assigned to you. If you don't have Internet access, or you don't have a (sic) assigned PIN please follow the directions below. If you provide your pin above we will electronically scan in all federal loan information for you. Please sign and return..."

The FAFSA PIN number is a 4-digit number that is used in combination with a borrower's Social Security Number, name, and date of birth to identify them as someone who has the right to access their own personal information on Federal Student Aid Web sites.

The security of the PIN is important because it can be used to:

- Electronically sign Federal Student Aid documents
- Access the student's personal records, and
- Make binding legal obligations

The Department has advised students that: "Your PIN can be used each year to electronically apply for federal student aid and to access your Federal Student Aid records online. If you receive a PIN, you agree not to share it with anyone. Your PIN serves as your electronic signature and provides access to your personal records, so you should never give your PIN to anyone, including commercial services that offer to help you complete your FAFSA. Be sure to keep your PIN in a safe place."

Loans made under the FFEL program must have a valid promissory note. (See 34 CFR 682.206(a).) The Department views a promissory note that the borrower does not sign and date as an invalid promissory note. When signing a promissory note, the borrower is certifying, among other things, that he or she is eligible for the loan on that date. An instruction to the borrower to not provide a signature date may invalidate the note and render the loan uninsured.

US Bank as HLT for Collegiate Solutions must immediately cease and desist from the mailing of unsolicited FFEL loan applications, requesting a borrower's PIN to access the borrower's personal records, and instructing a borrower to not provide a signature date on the application promissory note. If the Department concludes that this practice has not immediately ceased, the Department will apply sanctions to US Bank and may begin limitation, suspension, and/or termination actions.
Please confirm to the undersigned the corrective actions you have taken to address this matter. If you have questions or require additional information, please call Ann Maria Fusco at (646) 428-3774 or by email at AnnMaria.Fusco@ed.gov.

[Redacted text]

F. Peachey Bruce
Acting Director
Financial Partner Eligibility and Oversight
Program Compliance
Federal Student Aid
EXHIBIT 4
ALERT MEMORANDUM

TO: Sally Stroup
   Assistant Secretary
   Office of Postsecondary Education

FROM: Cathy H. Lewis
       Assistant Inspector General
       Evaluation, Inspection and Management Services

SUBJECT: Review of Lender Inducements (ED/OIG I13C0003)

This alert memorandum provides information from our review of lender inducements. The Office of Inspector General received an allegation that Sallie Mae was offering schools illegal inducements in return for Federal Family Education Loan Program (FFELP) loan volume. The allegation, from an anonymous source, did not include any specific information or evidence regarding illegal inducements.

The governing anti-inducement legislation, found in Section 435(d)(5)(A) of the Higher Education Act of 1965, as amended (HEA), prohibits a lender from offering, directly or indirectly, points premiums, payments, or other inducements, to any educational institution or individual in order to secure applicants for FFELP loans. Since the enactment of the legislation in 1986, the FFELP market has changed significantly with increasing demands for benefits or services by schools, the rising cost of education, and escalating competition for FFELP loans.

The Department’s interpretive guidance to the community through Dear Colleague Letters has not been updated since 1995. Informal guidance provided in letters and e-mails has not resolved the concerns of the FFELP participants as to what constitutes an inducement. Formal administrative enforcement action has been limited to one case, involving Sallie Mae’s agreement with Dr. William M. Scholl College of Podiatric Medicine. Federal Student Aid has never performed reviews of lenders for the specific purpose of reviewing compliance with the anti-inducement provision.

The Department held a series of meetings with the FFELP community in the spring and summer of 2001 to discuss anti-inducement issues, but no consensus was reached. In November 2001, the Consumer Bankers Association (CBA) and the Education Finance Council (EFC) issued a joint statement on their view of the applicability of the anti-

400 MARYLAND AVE., S.W. WASHINGTON, D.C. 20202-1510
Our mission is to ensure equal access to education and to promote educational excellence throughout the Nation.
inducement statute to the private credit offerings of FFELP lenders. In the statement, CBA and EFC declared that they believe it is illegal for a lender to require a school to refer FFELP loan applicants (including placing a lender on a preferred lender list) to the lender in exchange for private credit. A FFELP lender, however, could offer private credit in hopes of FFELP loan referrals from a school, and could subsequently alter the terms of any private loan agreement with a school, or cease to provide private credit if the FFELP loan volume was less than expected.

Sallie Mae and the National Council of Higher Education Loan Programs did not sign the statement. The Department has not taken a position on the joint statement and has not offered guidance on the growing market for private loans.

We met with representatives from Federal Student Aid (FSA), the Office of the General Counsel, the Office of Postsecondary Education (OPE), and the Office of the Deputy Secretary. We also interviewed representatives from Sallie Mae and other FFELP participants, including lenders, guaranty agencies, a school financial aid officer participating in the William D. Ford Federal Direct Loan Program (Direct Loan Program) and a lawyer with the legal aid community representing student interests. Although the parties we interviewed were knowledgeable and provided useful information on current practices in the FFELP market, none provided specific information regarding improper inducements provided by lenders at specific institutions.

We selected two schools for review based on an increase in Sallie Mae loan volume. We found evidence that one of these schools and Sallie Mae negotiated preferred lender status in exchange for a specified dollar amount of private loans.

Our review concluded there are bargaining practices between schools and lenders for FFELP preferred loan status and private loan volume that should be addressed through statutory and regulatory changes or further Department guidance. Given the current marketing practices by schools and lenders, the Department should examine the roles and responsibilities of schools, as well as lenders and lender affiliates in the inducement issue.

We recommend that in recognition of the current market realities in the FFELP, the Assistant Secretary for OPE:

- Provide guidance on the growing market for private loans by clarifying the application of the anti-inducement provision to private loans; and

- Reevaluate the anti-inducement provision of Section 435(d)(5)(A) of the HEA and determine if statutory changes should be proposed in the upcoming reauthorization to include schools, lender affiliates and other necessary changes.

cc: John Danielson
    Harold Jenkins
ENCLOSURE 3: SLX’s Comments on the Draft Report
June 2, 2008

Gloria Pilotti
Regional Inspector General for Audit
Office of Inspector General
U.S. Department of Education
501 I Street, Suite 9-200
Sacramento, CA 95814

Re: Response of Student Loan Xpress (SLX) to the Draft Audit Report Control Number ED-OIG/A09H0017

Dear Ms. Pilotti:

On behalf of Student Loan Xpress, Inc. (SLX), I would like to take this opportunity to provide the Office of Inspector General (OIG) with the attached response to the above-referenced Draft Audit Report (the Draft). SLX has reviewed and concurs with the response to the Draft being submitted this date by Fifth Third Bank, and believes that the magnitude of the subject portfolio and the relative importance of this matter warrant the submission of this supplemental response by SLX.

As stated in the attached response, SLX has a major economic and reputational stake in the proper resolution of this matter by OIG. SLX very much looks forward to working with the OIG towards such a resolution as promptly and efficiently as possible. Please do not hesitate to contact me if you have any questions concerning the attached or if you would like to discuss this matter in greater detail. Thank you very much for your careful consideration of this response.

cc: Brian Gardner
    FIFTH THIRD BANK
    Saul L. Moskowitz, Esq.
    MOSKOWITZ & AUSTIN, LLC
    Jonathan A. Vogel, Esq.
    SONNENSCHEIN NATH & ROSENTHAL LLP

Attachments

Student Loan Xpress, Inc., a CIT Company
One CIT Drive
Livingston, NJ 07039

Randall M. Chesler
President
This is to provide the Office of Inspector General (OIG) with the response of Student Loan XPress (SLX) to the above-referenced Draft Audit Report (the Draft). SLX respectfully refers OIG to the response of Fifth Third Bank with respect to Finding No. 2. This response addresses Finding No. 1 and the “Other Matter” section of the Draft. As the current beneficial owner of the loans involved in the transactions that are the focus of Finding No. 1 and some of the loans involved in the transactions discussed in the “Other Matter” section, SLX has a major economic and reputational stake in the proper resolution thereof by OIG. SLX requests that OIG give full consideration to this response in its development of the final audit report.

RESPONSE TO FINDING NO. 1

In Finding No. 1, the Draft addresses the compliance of three (3) transactions with § 435(d)(5)(A) of the Higher Education Act of 1965, as amended (HEA). That provision prohibits FFELP lenders from paying inducements in order to secure applicants for FFELP loans. See also 34 CFR 682.200 (definition of “Lender”, paragraph (5)(i))(July 1, 2007 ed.).

The Draft concludes that the transactions at issue violate § 435(d)(5)(A). It reaches this conclusion by radically recharacterizing the transactions in a manner that the Department of Education (ED) and the courts have long rejected, and employing an interpretation of § 435(d)(5)(A) that conflicts with its plain language. The Draft then recommends voiding the guarantee retroactively on over $3 billion in loans made pursuant to these transactions. This proposed penalty, which would cost the parties more than $3.5 billion, is exceedingly, harsh, disproportionate, and unprecedented.

The Draft’s recommendation does not just violate the legal rights of the parties to these transactions, however. It calls into question the guarantee and subsidy payments on tens of billions of dollars in loans held by other lenders all over the country. Expert Report of Seamus O’Neill, ¶¶II.A (O’Neill Rep.)(attached hereto as Appendix A). At a time when the program may well be on the brink of collapse due in substantial part to the

---

1 Transactions in the student loan industry, including those at issue here, are exceedingly complex. The dynamics of student loan finance, including the process by which outside parties decide to invest in FFELP loan-backed assets, is perhaps even more so. To assist OIG in understanding the industry, the market for credit, and the transaction structures and mechanics commonly employed in the industry, we have attached a report prepared by Seamus O’Neill, a widely recognized expert in such matters. Mr. O’Neill has reviewed the Draft, as well as the various agreements cited by the Draft with regard to the transactions at issue.
lack of confidence of the credit markets in the suitability of FFELP loans as investments, the Draft would inject a major new source of risk and uncertainty for current and potential investors in securities backed by such loans, thereby jeopardizing the fundamental ability of the FFELP to achieve its objectives. Id. It is certainly within the province of OIG to recommend the promulgation of new regulations or legislation to override longstanding ED interpretations of the statute and regulations, or to alter the rules laid down in well-settled judicial precedent. But it would be extremely damaging to the program, particularly at this point in time, to threaten the guarantee on tens of billions of dollars in existing loans that were made in reliance on those interpretations and precedent, and in which untold numbers of securities owners have invested.

Accordingly, Finding No. 1 should be omitted from the Final Audit Report. In the event that it is included, the proposed remedy should be solely that the parties be required to discontinue making loans under the transactions at issue.

A. Under longstanding ED policy and applicable case law, the form of the transactions at issue as sales of consummated loans must be respected.

1. The structure of the transactions at issue.

The structure of the transactions at issue is commonplace in the FFELP, and indistinguishable in all material respects from transactions under which tens of billions of dollars in FFELP loans have been made by numerous lenders over the years. Id. ¶ III.b.

The Lenders (PLP, MSA, and LSF) each entered into a trust agreement (each a "Trust Agreement", and collectively, the "Trust Agreements") with an ELT (Fifth Third Bank) under which the ELT holds legal title to Consolidation loans in the trust, and the Lender is the sole beneficial owner of those loans. The Trust Agreements require the loans to be funded with funds borrowed by the Lenders from a reliable liquidity provider (ELSI), and originated and serviced by an experienced third-party servicer (ELSI). They further require that the loans be covered by a forward purchase and sale commitment agreement with a well-established loan holder (SLX through its eligible lender trustee under a separate trust agreement) under which the loans are to be sold to such holder promptly after disbursement.

Each Lender entered into a loan servicing agreement (each a "Servicing Agreement", and collectively, the "Servicing Agreements") and an Administration Agreement with ELSI. The Lender thereupon conducted marketing/advertising activities commonly used throughout the industry in an effort to interest prospective borrowers in applying for Consolidation loans through the Lender. The Lender, through the ELT, then made Consolidation loans to eligible borrowers using funds borrowed under a credit and security agreement (each a "Credit and Security Agreement", and collectively, the "Credit and Security Agreements") entered into with a financing provider (ELSI). Then, pursuant to a forward purchase commitment/loan purchase and sale agreement (each a "Forward Purchase Agreement", and collectively, the "Forward Purchase Agreements"), the Lender (through its eligible lender trustee) sold, and SLX (through its eligible lender
trustee) bought, those loans after they were disbursed. The purchaser, the financing provider, and the third-party servicer/administrator were all affiliated with one another. The sale price included a premium above par, allowing the Lender to repay the funds borrowed from the financing provider and realize a profit.

The Draft Audit Report proposes to ignore the form of these transactions and treat them instead as the procuring of marketing services. The Draft recharacterizes the premiums paid for the loans as per loan marketing compensation, which the Draft then claims violates the inducements prohibition in § 435(d)(5)(A). The Draft offers only a cursory justification for recharacterizing the transaction in this manner. According to the Draft –

Under the terms of the ELT agreements and related agreements, MSA, PLP, and LSF are not lenders since the origination of FFELs is restricted to those exclusively funded, serviced, and purchased by SLX and its affiliates and the role of MSA, PLP, and LSF was limited to the securing of loan applications (marketing) and obtaining loan verification certificates. Also, an arms-length sale of loans did not occur. Fifth Third Bank holds loans in trust under its ELT agreements and SLX is a party to the trust with exclusive rights to the loans. Basically, SLX is transferring its interest in the loans held in one trust (trust established by the ELT agreement with SLX/MSA, SLX/PLP, and SLX/LSF) to another trust to which SLX or an affiliate of SLX is a party.... [U]nder the ELT agreement, MSA remained solely a marketer, that is, an entity that secured loan applications for lenders.

2. Under ED’s longstanding interpretation of the statute and regulations, the form of the transactions must be respected.

Since these transactions involve the sale of consummated loans and not the securing of loan applicants, they do not involve illegal inducements. Rather, they reflect Example No. 1 of “Permissible Activities” described in ED’s Dear Colleague Letter No. L 89-L-129 (February 1989) (the “DCL”), which reads in pertinent part as follows:

A lender purchases a loan made by another lender at a premium. This is not a transaction involving the securing of applicants, but rather the acquisition of loans already made. A purchasing lender may also act as the agent of a selling lender on a loan to be purchased for purposes of originating and disbursing the loan, and purchase the loan at a premium immediately following disbursement. The funds used to make the loan would be deemed to have been advanced to the seller by the purchaser and subsequently repaid from the sale proceeds.²

² This type of transaction is also permitted under ED’s new anti-inducements regulations, which take effect July 1, 2008. See 34 CFR 682.200(b)(definition of “Lender”, paragraph (5)(ii)(H)(2007).
In fact, the transactions at issue here are even more clearly the sale of loans funded by the seller with funds borrowed from the buyer than the transaction described in the DCL. The borrowings here are governed by an express credit extension contract containing customary terms and conditions. Unlike in the DCL example, there is no need to “deem” the funds used to make the loans to have been advanced by the purchaser; the Credit and Security Agreements make that component of the arrangement crystal clear.

These transactions are also indistinguishable in all material respects from the transactions between non-school lenders and financing providers/servicers/purchasers that ED confirmed are permissible in the proceedings involved in Student Loan Marketing Ass'n v. Riley, 112 F.Supp. 2d 38, 48 (D.D.C. 2000) (hereinafter “Riley”).

Thus, under ED’s longstanding interpretation of the HEA and implementing regulations, the form of these transactions must be honored. They are sales of consummated loans, not the purchase of marketing services, and must be treated accordingly. As ED is well aware, such transactions have become commonplace in the industry, as FFELP participants, including the Lenders and SLX, have structured their relationships in the program in reliance on ED’s position as enunciated in the Riley proceedings and consistently applied thereafter. O’Neill Rep. ¶III.b. ED is not permitted to simply renounce that interpretation of the HEA and regulations, as the Draft recommends, especially with regard to loans made in reliance thereon. See e.g. Smiley v. Citibank, 517 U.S. 735, 742 (1996) (sudden, unexplained, unexpected, policy change, or change that does not take account of legitimate reliance on prior interpretation, may be arbitrary, capricious, or abuse of discretion); Paralyzed Veterans of America, et al v. D.C. Arena L.P., 117 F. 3d 579, 586 (CA DC 1997) (reversal of agency’s interpretation of regulations requires notice-and-comment rulemaking); Microcomputer Technology Institute v. Riley, 139 F. 3d 1044, 1050 (CA 5 1998) (retroactive application of Secretary’s new interpretation of HEA to a party who relied on the prior interpretation held so unfair as to be arbitrary and capricious); Torch Operating Company v. Babbitt, 172 F. Supp. 2d 113, 125-26 (D.D.C. 2001) (agency’s “consistent practice” in applying its regulations amounts to an interpretation of such regulations, such that, under Paralyzed Veterans of America, et al v. D.C. Arena L.P., the agency may not then adopt a different interpretation without going through notice-and-comment rulemaking). 3

---

3 On November 1, 1999, during the pendency of the Riley case, ED issued regulations implementing the inducements prohibition of HEA § 435(d)(5)(A). See 34 CFR 682.200 (definition of “Lender”, paragraph (5)(i)), published in final at 64 Fed. Reg. 58952 (Nov. 1, 1999). The specific ED statements alluded to by the Court in Riley confirming the permissibility of transactions among non-school lenders were made prior to that date. However, ED’s confirmation of this interpretation was repeatedly brought up by Sallie Mae in that case and was an important element in the Court’s ruling, yet at no time did ED disavow it. See Riley, supra, at 48. Moreover, ED’s consistent administrative practice since Riley is in accord with that interpretation. Thus, it is clear that since § 682.200 (definition of “Lender”, paragraph (5)(i)) was promulgated in November 1999, ED has consistently interpreted that regulation as permitting transactions such as those at issue here. Accordingly, the Draft’s recommendation that ED reverse that interpretation without notice-and-comment rulemaking is precluded by Paralyzed Veterans of America, et al v. D.C. Arena L.P., supra, and Torch Operating Company v. Babbitt, supra.
3. **Settled case law also requires that the form of the transactions be respected.**

Under settled case law, it is likewise clear that the form of these transactions must be respected.

In Riley, at issue was a relationship between a purchaser/servicer/financing provider for FFELP loans (Student Loan Marketing Association, often referred to as “Sallie Mae”), and Dr. William M. Scholl College of Podiatric Medicine (“Scholl College”), a school acting as a FFELP lender for its students. The relationship was virtually identical to the transactions at issue here, with one major difference: the lender was a school.

Under the Sallie Mae/Scholl College arrangement, the loans were originated and disbursed by Sallie Mae as third party servicer for Scholl College. Sallie Mae lent Scholl College the funds used to make the loans. The loans were required to be sold to Sallie Mae at a premium prior to entering repayment pursuant to a forward purchase commitment/loan sale agreement. Id. at 38-41.

Unlike the Draft’s approach in this instance, ED never sought to void the guarantee on loans made pursuant to the Sallie Mae/Scholl College arrangement. Instead, it commenced a “limitation” proceeding, in which it asked an Administrative Law Judge (ALJ) to issue an order requiring the arrangement to be discontinued. ED argued that the form of the arrangement, which was structured as a sale of consummated loans, should be ignored and the arrangement recharacterized as involving Sallie Mae as the “true lender” paying inducements to Scholl College to compensate Scholl College for securing loan applicants for Sallie Mae, in violation of HEA § 435 (d)(5)(A). Id. at 41-43.

Twice, the ALJ refused to recharacterize the arrangement, whereupon on each occasion the Secretary of Education overruled the ALJ. After the Secretary overruled the ALJ for the second time, Sallie Mae sued in the U.S. District Court for the District of Columbia. Id. at 42.

The Court overturned the Secretary’s decision, rejecting ED’s attempt to recharacterize the Sallie Mae/Scholl College arrangement on several different grounds. Each of those grounds that is relevant here *independently* requires rejection of the Draft’s proposed recharacterization of the transactions at issue.

First, the Court held that, contrary to ED’s contention, the HEA, the FFELP regulations, and the legislative history permit schools to act as lenders, and to hire third party servicers to carry out the functions of a lender on its behalf, “even if the arrangement effectively renders the school lender a mere marketer...”, and even if it means that the school lender “assumes no significant financial risk.” Id. at 43-44.

In the instant transactions, the role of schools in the program is simply not at issue. The Lenders, through the ELT, provide an important source of competition in the
program. See GAO Report GAO/HEHS 00-170, Trustee Arrangements Serve Useful Purpose in Student Loan Market, at 15 (Sept. 2000)("[T]rustee arrangements between eligible and ineligible lenders serve an important role in enabling ineligible lenders to participate in FFELP, and in protecting the federal government's investment in the program."). Even though the Lender's primary (but not exclusive) activity under the instant transactions is to market their loans, and even if their financial risks are limited, Riley makes clear that those facets of the transactions cannot justify recharacterization.

Second, the Court in Riley held that recharacterizing the arrangement was unjustified because there was no evidence that it resulted in the exploitation of any borrowers or resulted in any "unnecessary or excessive borrowing". Id. at 45.

Here, there is no evidence that any of the transactions caused exploitation of or any other harm to any borrower. No school or any other party in a position of trust and influence with a borrower received any payment to steer the student to a lender. It is also important to remember that, unlike in Riley, the loans at issue here are Consolidation loans, under which existing debt is restructured to ease the repayment burden of the borrower. Accordingly, no "unnecessary or excessive borrowing" occurred. Id. at 46.

Third, the Court held that, since the component agreements were all permissible, the Sallie Mae/Scholl College arrangement as a whole could not be deemed impermissible. Id. at 46-47.

In this instance, the Draft does not claim, nor can it, that any of the component agreements violate the HEA or any implementing regulations. Although trust relationships were not involved in Riley, the HEA and the FFELP regulations specifically permit loans to be made and held pursuant to trust relationships. HEA §§ 426, 436(b); 34 CFR 682.203(b).

Fourth, the Court held that the form of the Sallie Mae/Scholl College arrangement must be respected because each of the component agreements, and the benefits derived therefrom by Scholl College, were market reasonable for a traditional secondary market arrangement. Id. at 46-48.

Each of the component agreements in the instant transactions, and the benefits derived therefrom for the Lenders, are likewise traditional, customary, and unremarkable. O'Neill Rep. at ¶III.c.

This includes in particular the provisions in the Trust Agreements requiring the loans to be funded with funds borrowed by the Lenders from a specific reliable liquidity

---

4 The Court phrased this in a variety of ways: It noted that the agreements contained "terms which are characteristic of traditional market transactions"; the contracts did not contain "unreasonable or non-market terms"; the arrangement was comprised of "market transactions typical of the secondary loan market"; the incentive that Scholl College had to enter into the arrangement was "unremarkable"; and the individual agreements were "traditional and customary of second-market transactions..." Riley, at 46-48.
provider, originated and serviced by a specific experienced third-party servicer, and subject to sale promptly after disbursement under a forward purchase and sale commitment with a specific well-established loan holder. Prudent ELTs, financing providers, and loan purchasers routinely require such restrictions, especially when the beneficial owner is new or relatively new to the lender role. Id. ¶III.d. Such provisions give these parties confidence that loans in the trust are properly funded and serviced, and are committed for sale to a reliable FFELP loan purchaser prior to the first payment due date (when administration of a loan becomes substantially more complicated).

It is indeed ironic that the Draft points to these provisions to justify disregarding the form of the transactions, while at the same time criticizing Fifth Third in Finding No. 2 for an alleged failure to take adequate steps to ensure that the Lenders comply with the FFELP statute and regulations. OIG cannot have it both ways.

As noted above, each of the grounds for rejecting recharacterization cited by the Court in Riley that is relevant here independently requires rejection of the Draft’s proposed recharacterization. The fact that every one of those various rationales precludes recharacterization here demonstrates, a fortiori, that the Draft’s approach is unsupportable.

Moreover, Riley involved a school lender, where the concerns regarding the pernicious effects of illegal inducements are the greatest. Inasmuch as Riley rejected ED’s effort to ignore the form of transactions indistinguishable from those at issue in this audit, and involving a school lender, it is clear that the form of the transactions involved here cannot be disregarded. Indeed, ED repeatedly confirmed in the course of the Riley proceedings that, had the arrangement in that case involved a non-school lender, it would have been permissible. Id. at 48.

The Draft places great emphasis on the fact that each Lender was a contract marketer for SLX prior to the transactions at issue, and allegedly remains “solely a marketer” under those transactions. The Lenders were not “solely” marketers in these transactions, however. Among other things, the Lenders borrowed money to fund their loans pursuant to bona fide credit transactions undertaken pursuant to the Credit and Security Agreements. Further, they obligated themselves under the Forward Purchase Agreements to repurchase any loan that becomes uninsured due to a violation that occurs prior to the sale of the loan to SLX. This is no small matter. Indeed, one of the Lenders has already repurchased in excess of $1 million in loans sold to SLX under their Forward Purchase Agreement that turned out to be uninsured when sold. Clearly, the Lenders’ roles as debtor and loan seller in the transactions at issue require them to accept substantial obligations not required of mere marketers. In fact, these are the very types of obligations that have led other marketers to decide not to become lenders. O’Neill Rep. ¶III.f.

5 In addition to the various rationales described above, the Court also rejected ED’s attempt to recharacterize the transactions at issue in Riley because it was “irrational” to recharacterize the transaction “merely because the [lender] was a school.” Riley, supra, at 48.
In any case, even if the Lenders had not had substantial duties and obligations beyond marketing loans, Riley makes clear that transactions such as those at issue here are permissible “even if the arrangement effectively renders the ... lender a mere marketer”. Riley, 112 F. Supp. 2d at 44. An otherwise permissible secondary market transaction cannot become illegal merely because the lender previously acted as a marketing service provider for the loan purchaser.

Finally, the Draft’s condemnation of the way in which the Lenders converted from marketing contractors to full-fledged lenders ignores fundamental facets of the operation of the FFELP. Many FFELP lenders, including some of the largest in the program, started as marketers. O’Neill Rep. at ¶11(e). And most new FFELP lenders first embark on that role via relationships with established FFELP industry participants like SLX that are substantively indistinguishable from those involved here. Id. The Draft’s proposed ban on marketing entities becoming lenders via relationships like the ones at issue here would therefore have effectively foreclosed program participation to many lenders that have provided vigorous competition for Sallie Mae and large bank lenders in the program, to the benefit of borrowers and the Federal Government alike.

4. The Draft’s reliance on the fact that SLX was a party to the Trust Agreements is misplaced.

The Draft assigns great importance to the fact that SLX was a party to the Trust Agreements. In fact, the Draft concludes that the transactions involved here were illegal, and declines to reach that conclusion with respect to the other trust arrangements it reviewed, based solely on the fact that the instant transactions, unlike the others, involve trust agreements to which the loan purchaser is a party. However, the Draft’s emphasis on this particular detail of the transactions at issue is misplaced.

As a threshold matter, the HEA and the FFELP regulations specifically permit loans to be made and held pursuant to trust relationships. Nothing in the HEA or the regulations addresses, much less prohibits, the purchaser of loans made by a trust from being a party to the trust agreement. Accordingly, since all the component agreements, including the Trust Agreements, are permissible, the Court’s ruling in Riley precludes ED from treating the instant transactions as a whole as impermissible, regardless of the fact that SLX signed the Trust Agreements. Riley, at 46-47.

Moreover, the Draft characterizes SLX’s role in the Trust Agreements as “structural” when it is, in fact, de minimus. While those agreements contain provisions devoted to detailing the extensive duties of the Lenders and the ELT, there is no such section for SLX. In fact, SLX’s only ongoing role under the Trust Agreements is to pay the ELT’s fees and expenses on the Lenders’ behalf. PLP Trust Agreement, § 1.10. Analytically and economically, this is simply a miniscule component of the loan sale premiums, and could just as easily (and perhaps more appropriately) have been
incorporated into the Forward Purchase Agreements, or omitted altogether in favor of a tiny increase in those premiums.\(^6\)

ED has long recognized and condoned the practice of a loan purchaser paying fees due on purchased loans on the seller’s behalf. See 34 CFR 682.305(a)(4)(i)(July 1, 1994 ed.) (purchaser may pay origination fees on seller’s behalf); 59 Fed Reg 61426 (November 30, 1994) (“A purchasing lender may reimburse the originating lender for the origination fees [on a purchased loan]”). That SLX paid the ELT’s exceedingly modest fees and expenses on behalf of the Lenders is clearly “unremarkable” and not “unreasonable or non-market”, and therefore cannot be a basis for ignoring the form of the transactions negotiated by the parties. Riley, at 46-48.

Finally, we note that OIG correctly declined to conclude that the form of the arrangement involving the Alder School of Professional Psychology (ASPP) should be disregarded even though the trust agreement there calls for SLX to compensate Fifth Third Bank for the services it renders as trustee for ASPP on loans sold to SLX. See Draft at 15. It should do likewise with respect to the three arrangements involved in this Finding.

The Draft erroneously claims that the Trust Agreements grant SLX an “interest” in loans in the trust. The Lenders, not SLX, are the full and exclusive beneficial owners of the loans residing in the respective trust estates. See e.g. PLP Trust Agreement, §§ 1.2, 1.4(a), 1.4(g); PLP Forward Purchase Agreement, § 4(e). Further, the Lenders incur a myriad of obligations and potential liabilities as borrowers under the Credit and Security Agreements and loan sellers under the Forward Purchase Agreements. See e.g. PLP Credit and Security Agreement, § 2.1, (PLP obligation to repay funds advanced to PLP by ELSI); § 2.2 (PLP obligation to pay interest on advanced funds); § 8.1(b)(PLP obligation to pay all expenses incurred by ELSI as financing provider); PLP Forward Purchase Agreement, § 3(j)(Seller’s obligation to pay origination fees, lender fees, and guarantee fees), § 6 (Seller’s obligation to repurchase loans that are not enforceable, guaranteed, and eligible for Interest Benefits and Special Allowance payments when sold). The contention that the matrix of rights and duties that comprises each of these transactions should be ignored simply because the handwriting of an SLX officer appears on the Trust Agreements, or because SLX paid economically insignificant fees and expenses on the Lenders’ behalf, places far more weight on those innocuous facts than they can plausibly be asked to bear. Such trivialities are plainly insufficient to invalidate the guarantee on over $3 billion in loans made under transactions that are otherwise indistinguishable in all material respects from the paradigm condoned by ED and approved in Riley. Were it otherwise, it would be impossible to identify from among the myriad of similar transactions undertaken since Riley, which is permissible, and which -- due to some insignificant provision purportedly “distinguishing” it from the Riley transaction -- is not. Substantial doubt would be cast on the guarantees on tens of billions of dollars in outstanding loans. This is quite simply an unacceptable result for the

\(^6\) For example, the total fees paid to the ELT under the three arrangements were $444,720.45, and the loans originated thereunder totaled $3.332 billion, which would translate into an increase in loan premiums of 0.013%.
viability of the program, especially given today’s tenuous conditions in the credit markets.

For these reasons, the Draft’s attempt to ignore the form of the transactions at issue should be rejected. They are what they purport to be -- the sale of consummated loans -- and must be treated accordingly.

B. Marketing does not constitute “securing” applicants, regardless of how the marketer’s compensation is calculated.

Section 435(d)(5)(A) provides in pertinent part that a lender can be disqualified from FFELP participation if the Secretary determines, after notice and opportunity for a hearing, that the lender has --

[O]ffered, 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....

20 U.S.C 1085(d)(5)(A). See also 34 CFR 682.200 (definition of “Lender”, paragraph (5)(i)) (July 1, 2007 ed.).

The principal focus of § 435(d)(5)(A) was to outlaw lender payments to schools in exchange for the schools’ recommending the lender to their students. Riley at 45, 48. The school’s role as trusted advisor to its students enables it to exercise substantial influence over a student’s decision whether to borrow, in what amount, and from which lender. When a school uses this influence to steer students to a particular lender, it is doing much more than merely “marketing” for a lender; it is incontestably “securing applicants” for that lender. Any reading of the statute that does not prohibit a lender from paying schools to do this, regardless of the form of payment, cannot be reconciled with its plain meaning.

Accordingly, where payments to schools are involved, ED has never made distinctions based on the form of payments or how they are calculated; any payments by a lender in exchange for loan referrals by a school are prohibited. See e.g. DCL at 2-3. ED’s treatment of transactions between lenders and non-school affiliated entities, however, has not been nearly so clear. ED currently takes the position that marketing fees paid by lenders to non-school affiliated entities are permissible if paid on a per application basis, but not if they are paid on a per loan basis.7 If the Draft’s

7 This has by no means been ED’s consistent position. A review of ED’s interpretations, re-interpretations, and corrections of interpretations on the marketing compensation issue over the years is set forth in Appendix B to this response. As Appendix B illustrates, the issue remains muddled to this day. Accordingly, a court would accord little or no deference to ED’s current position. See Good Samaritan Hospital, et al. v. Shalala, 508 U.S. 402, 417 (1993) (“an agency interpretation of a relevant provision which conflicts with the agency’s earlier interpretation is ‘entitled to considerably less deference’ than a consistently held agency view.”); Barnett v. Weinberger, 818 F.2d 953, 962 (CADC
recharacterization of the transactions at issue here were accepted, the premiums paid to the Lenders on the loans sold pursuant to the Forward Purchase Agreements might be similarly recharacterized as (purportedly) prohibited per loan marketing compensation being paid by the "real" lender, SLX (via its trustee). This is apparently the analysis employed in the Draft.

For the reasons discussed below, however, the "per app/per loan" distinction relied on by the Draft cannot be squared with the plain language of the statute. Section 435(d)(5)(A) unambiguously states that any payment for securing loan applicants is impermissible, regardless of how it is calculated. However, marketing does not constitute "securing" loan applicants, again, regardless of how the marketer is compensated. Accordingly, even assuming, arguendo, that the transactions at issue can be recharacterized as involving per loan marketing compensation, that compensation did not constitute an inducement to secure loan applicants for any lender within the meaning of HEA § 435(d)(5)(A).

Section 435(d)(5)(A) establishes two prerequisites for an illegal inducement: (1) there must be an offer of "points, premiums, payments, or other inducements"; and (2) such inducements must be offered "in order to secure applicants" for FFELP loans.

The first element is unambiguous: any form of "payment" suffices if it is offered for the proscribed purpose of securing loan applicants. The plain language of the statute

---

1987)(agency interpretations of a statute that are neither contemporaneous with enactment of the statute nor consistent with earlier interpretations "do not merit a substantial degree of respect"); Idaho Power Co. v. FERC, 312 F.3d 454, 461 (CADC 2002) (no deference is due to FERC interpretation of a tariff that is inconsistent with prior agency interpretations); United Transportation Union, et al., v. Lewis, 711 F.2d 233, 242 (CADC 1983)(statutory construction to which an agency has not consistently adhered "is owed no deference").

8 The Draft's discussion of the marketing compensation issue is confusing. It repeatedly equates all marketing with "securing" applicants, yet cites with apparent approval the "flat fee" payments made in the past to the Lenders when they were mere marketers. Given the broad prohibition in the HEA on "payments" to secure applicants, it is not clear what the Draft's rationale is for approving these payments while disapproving the premiums paid to the Lenders under the Forward Purchase Commitment/Loan Purchase and Sale Agreements. Although it does not clearly say so, it appears that the Draft is applying the "per app/per loan" compensation distinction described above.

9 When ED adopts an interpretation of the HEA that cannot be squared with its plain language, the courts will not hesitate to overturn that action. See Jordan v. Secretary of Education, 194 F.3d 169, 172 (D.C. Cir. 1999) ("the Secretary may not rewrite the [FFELP] statute"); California Cosmetology Coalition v. Riley, 110 F.3d 1454 (9th Cir. 1997); Smithville R-II School Dist. v. Riley, 28 F.3d 55, 57-58 (8th Cir. 1994); Atlanta College of Medical & Dental Careers v. Riley, 987 F.2d 821 (D.C. Cir. 1993) ("no deference is due to [Secretary's] interpretation" that was "foreclose[d]" by the "text" of the HEA); Riley, supra, at 48; Bank of America NT & SA v. Riley, 940 F. Supp. 348 (D.D.C. 1996) (Secretary's interpretation of 20 U.S.C. §§ 1077a(i)(7)(B) and 10871(b)(2)(A) contradicted express requirements of statute), aff'd, 132 F.3d 1480 (D.C. Cir. 1997); Student Loan Marketing Assn v. Riley, 907 F. Supp. 464 (D.D.C. 1995) (Secretary's HEA interpretation which failed to give effect to "clear statutory definition" was "arbitrary and capricious"), aff'd, 104 F.3d 397 (D.C. Cir. 1997).
does not allow for distinctions based on the form of the payment or how it is calculated. Compare HEA § 487(a)(20) (prohibiting schools from paying "any commission, bonus, or other incentive payment based directly or indirectly on success in securing enrollments or financial aid" to anyone engaged in recruiting, admissions, or awarding financial aid). Congress clearly knows how to prohibit marketing compensation calculated in a particular way while permitting other types of marketing compensation, yet did not do so in § 435(d)(5)(A). See also DCL at 1 ("The Department believes these provisions were broadly intended to prohibit the direct or indirect offering or payment of any kind of financial incentive...regardless of the form of the incentive or its mode of payment.").

Moreover, no reading of the plain language of the statute could support the contention that paying a fee per application is less aptly characterized as a payment in order to secure applicants than a fee paid per loan. Such a reading would contort the word “applicants” beyond all recognition.

Once an offer of any form of payment exists, the sole remaining question is whether it is made in order to “secure” loan applicants. Unlike “payment”, the term “secure” is unclear. However, it cannot reasonably be read as including all marketing of FFELP loans, as the Draft appears to contend. First, the term "securing applicants" on its face would seem to require more than the mere delivery of a brochure or presentation by a marketer who occupies no special position of trust or influence with the borrower. Second, reading the statute to prohibit all compensated marketing would mean that virtually every FFELP lender since 1986 has been in continuous violation of the statute, inasmuch as compensated marketers have long been the norm in the industry. O’Neill Rep. III.g. It is inconceivable that such a reading could be supportable today given that the FFELP statute has been reauthorized three (3) separate times since 1986, and amended on numerous other occasions, with no suggestion from Congress that this widely known element of the FFELP program was impermissible.

Thus, the term “secure” must be read to prohibit lenders from paying schools to steer borrowers to the lender, regardless of the basis of payment, while at the same time permitting compensated marketing activities by non-school affiliated entities. The most logical and straightforward approach for doing this is to interpret the term “secure” to permit mere “marketing”, where the lender or marketing agent must rely solely on the merits of the lender’s loan products and service, but to prohibit paid “referrals”, i.e., paying someone who likely has the trust of the student (such as a school’s financial aid office) to influence the student’s borrowing decisions. Indeed, the DCL took this approach. It recognized that “generalized marketing” did not constitute “securing” applicants, and therefore could be compensated as the parties saw fit, while at the same time it prohibited “referral” fees to compensate lenders who, by exploiting existing relationships with potential FFELP borrowers, were able to steer them to another lender for a FFELP loan. DCL at 2-3.11

10 At the time of the DCL, many banks did not participate in the FFELP. When an existing customer of a nonparticipating bank asked for a FFELP loan, the bank would refer the customer to another lender that did
Unlike the DCL, the Draft seeks to characterize marketing activity as “securing” applicants if the activity is compensated on a per loan basis, but not if the same activity is compensated on a per application basis. Whether an activity rises to the level of “securing” applicants, though, depends on the nature of the activity itself. The form or basis of compensation paid to procure the activity is analytically irrelevant.

Thus, even if the transactions at issue could be recharacterized as proposed by the Draft, the payments made thereunder would merely be compensation for marketing by a non-school affiliated entity with no special position of trust or influence with prospective borrowers, and not for referrals. There is no basis under the HEA to treat any of those payments as being made “in order to secure applicants” for SLX.

Moreover, as noted above, treating some payments for a given activity as permissible and others as prohibited does violence to the clear statutory prohibition on all payments in order to secure applicants, regardless of how they are calculated.

The DCL provides that, while it is permissible for a lender to pay another lender to process applications and advertise the originating lender’s loans, a lender may not pay another lender a fee that purports to be for processing or advertising, but is also or in actuality compensation for the payee lender referring borrowers to the paying lender. DCL at 2 (Example of Prohibited Inducements No. 3). As the DCL makes clear, “referral” is different from “marketing”. Id. at 2-3 (prohibiting payments for referrals while permitting payments for “generalized marketing or advertising”). See also id. at 2 (Example of Prohibited Inducements No. 4)(payments that are labeled as “processing” fees, but are in reality compensation for referral by the lender receiving the payment, are prohibited regardless of the label).

Moreover, the term “person” is defined in the general definitions section of the United States Code as follows:

The words “person” and “whoever” include corporations, companies, associations, firms, partnerships, societies, and joint stock companies, as well as individuals ...  

1 U.S.C. § 1. Clearly, “person” and “individual” are not synonymous when they are used in the United States Code. When Congress intends to regulate the activities of both legal entities and human beings, 1 U.S.C. § 1 states that Congress uses the term “person”, not “individual”.

- 13 -
C. Voiding reinsurance on the loans at issue would be unprecedented, unwarranted, and harmful to the FFELP.

Relying solely on regulations that OIG claims authorizes treating the loans made pursuant to the transactions at issue as unreinsured from inception, the Draft recommends that ED void the guarantee on those loans and require the ELT to reimburse ED for all claims payments, interest benefits, and special allowances paid in the past thereon. This recommendation would impose a penalty on the parties of more than $350 million. The Draft fails to recognize that such a penalty would be utterly unprecedented, and suggests no reason why such a harsh sanction would be warranted or in the best interests of the FFELP.

It is our understanding that, in the 22-year history of the inducements prohibition, ED has never treated a loan as unreinsured due to an inducements violation. Instead, the participants in activities found to constitute inducements violations have typically been instructed to discontinue those activities.

ED's consistent policy with regard to referral fee violations in particular has been that such infractions do not justify voiding reinsurance or restricting interest benefits and special allowance on affected loans. For example, in correspondence between ED's Division of Policy Development (DPD) and ED's Atlanta Regional Office, DPD addressed a situation in which a lender paid other lenders a referral fee based on loans disbursed rather than applications processed. DPD directed the Regional Office as follows:

[DPD does] not believe that this violation warrants a voiding of reinsurance or restriction of interest and special allowance on loans previously disbursed under the referral program. Instead, the lender should be cited and instructed to restructure its referral program by a specified deadline if it wishes to continue

Finally, interpreting “individual” to include corporations would render superfluous the term “educational institution” as used in § 435(d)(5)(A). See Alaska Dep't of Environment Conservation v. EPA, 540 U.S. 461, 489 n.13 (2004) (courts disfavor rendering statutory provisions superfluous). Accordingly, a court may well read § 435(d)(5)(A) to only bar payments made to educational institutions or human beings. The Lenders are neither.

While technically distinct, “voiding the guarantee” on a loan and treating it as unreinsured have the same effect -- i.e., they both result in the loan being ineligible for Federal subsidies and guarantor claim payments. Accordingly, the two concepts are used interchangeably in this response.

In the proceedings involved in Riley, ED did not even feel comfortable issuing its own “cease and desist” directive. Instead, it commenced a limitation proceeding, asking that an Administrative Law Judge issue a “limitation” directing Sallie Mae to end the relationship with Scholl College. As noted above, the Riley matter involved alleged inducements paid to a school, a far more serious situation from the perspective of the inducements prohibition than the alleged “marketing” compensation to non-school affiliated entities involved in the transactions at issue here.
it....The lender should be told that its failure to comply will result in its ineligibility as a lender in the FFEL program.

See Question & Answer from Robert Evans, Director, DPD, to Barbara Gray, Region IV, dated March 6, 1994(emphasis supplied).17

ED’s refusal to penalize the payment of referral fees by unreinsuring affected loans is sound policy, and consistent with ED’s longstanding practices in exercising its regulatory authority to unreinsure loans. In a Federally-guaranteed loan program that depends upon voluntary participation by private financial institutions, it is essential that those institutions be able to rely on the Federal guarantee. O’Neill Rep. ¶III.h. In recognition of this, ED has typically employed the drastic step of voiding reinsurance only in situations where fraud is involved, or where the violation harmed the collectibility of the loan. In practice, this has meant that virtually all instances (not involving fraud) in which reinsurance has been reduced or voided have involved violations of the lender’s obligation to diligently collect a delinquent loan or file a claim thereon in a timely manner.18 Moreover, even in cases involving such violations, ED has voided reinsurance only where the violation was substantial, rather than technical, and the lender was unable to “cure” the violation by subsequent collection efforts. See DCL 88-G-138 (1988)(included with revisions as 34 CFR Appendix D).

The Draft proposes that ED void the guarantee on every loan made under the transactions at issue, despite the lack of any evidence of fraud or harm to the collectibility of the loans, and despite ED’s longstanding policy of not voiding the guarantee for inducements violations in general and referral fee violations in particular. Thus, the Draft urges ED to depart radically from its consistent standards and practices in implementing its regulatory authority to unreinsure a loan.19 The HEA prohibits OIG from making such a recommendation, however. HEA § 432(f)(4)(OIG audits of FFELP lenders must focus on “rules and regulations prescribed by the Secretary in effect at the time that the record was made, and in no case shall the ... Inspector General apply subsequently determined, standards, procedures, or regulations to the records of such ... lender”). Nor could ED adopt such a recommendation. Smiley v. Citibank, supra, 517 U.S. at 742; Paralyzed Veterans of America, et al v. D.C. Arena L.P., supra, 117 F. 3d at 586; Torch Operating Company v. Babbitt, supra, 172 F. Supp. 2d at 125-26.

17 It is also exceedingly difficult to reconcile the harsh remedy recommended by the Draft with the OIG’s longstanding recognition that the scope and meaning of the anti-inducements prohibition is unclear, imperfectly understood within ED and in the industry, and in need of clarification by ED. See Alert Memorandum from C. Lewis to S. Stroup (Aug. 1, 2003).

18 ED also treats loans as unreinsured when statutory prerequisites for the payment of reinsurance, interest benefits, and special allowance are not met – for example, when the loan is held by an ineligible lender. No such circumstance is involved here.

19 As noted above, even recharacterized, the instant transactions involve compensation for marketing, where no exploitation of a position of trust or influence with the borrower is involved, and not referral fees. Since ED’s policy and practice has been to not unreinsure loans based on the payment of illegal referral fees, a fortiori, it should not do so for purported marketing compensation violations.
Furthermore, even if ED could legally adopt the sanction the Draft proposes, there are compelling reasons why the OIG should not recommend that it do so.

The utter disproportionality of the Draft’s recommended $350 million penalty is manifest. The “violations” alleged by the Draft had no effect on the risk of loss on the loans. There is no evidence of fraud. There is no evidence that any harm befell any borrower or ED. There is no evidence that any inducements were offered to any school. And, as noted above, the loans at issue here are Consolidation loans. No new debt was created. Thus, the purposes of the inducements prohibition itself - preventing borrowers from borrowing more than they need or can repay, Riley at 45 - are not implicated here.

The irrationality of the Draft’s recommended penalty is underscored by the fact that the Draft would apparently recommend no penalty at all — indeed it would find no violation — had the alleged “marketing compensation” been calculated on a per application, rather than per loan, basis. While ELSI is still analyzing the data, it appears that virtually 100% of the completed applications received under the arrangements at issue became loans. For ED to impose a penalty of more than $350 million dollars based on such an economically insubstantial distinction would plainly be arbitrary, capricious, and an abuse of discretion.

Perhaps most importantly, however, the massive penalty recommended by the Draft would inject a major new source of risk and uncertainty into the FFELP. Today, the program may very well be on the brink of collapse due in substantial part to the lack of confidence of the credit markets in the suitability of FFELP loans as investments. O’Neill Rep. ¶III.a. By casting doubt on the guarantee of tens of billions of dollars in outstanding loans in which untold numbers of securities holders have invested, by doing so in the context of transactions long condoned by ED and settled case law, and by doing so despite the utter lack of evidence showing any harm befell any borrower or the Federal Government, the Draft’s approach would greatly exacerbate this condition. Id. As Mr. O’Neill notes —

[I]t is essential that [FFELP lenders] be able to rely on the Federal guarantee, and consistent application of laws and regulations over time. Consistent treatment of like financing and loan origination structures by the government makes the financing of loans possible. Inconsistent treatment will have the opposite effect.

Id. at ¶III.b.

Finally, it is critical that OIG understand that merely including the recommendation to unreinsure the loans at issue in the Final Audit Report would likely create a major obstacle for FFELP lenders trying to locate the financing they need to continue to make loans in the program. Id. ¶III.a.
Conclusion

The Draft’s proposed $350 million penalty is exceedingly harsh, disproportionate, and unprecedented. It fails to accord simple fairness to the parties to these transactions, and jeopardizes the fundamental ability of the FFELP to achieve its objectives. It is based on alleged violations that harmed no one and can be “found” only by radically recharacterizing the transactions in a manner that ED and the courts have both rejected, and employing an interpretation of the statute that conflicts with its plain language. It should be rejected. Instead, if the Final Report retains this Finding at all, the recommended remedy should be that the parties be required to discontinue making loans under the transactions at issue.\(^{20}\)

RESPONSE TO “OTHER MATTER” DISCUSSION

The response to Finding No. 1, above, explains why the transactions at issue there cannot be recharacterized as mere marketing arrangements involving purportedly illegal per loan compensation. Those arguments also apply to the arrangements that are questioned in the “Other Matter” section of the Draft.\(^{21}\) If the Final Report rejects those arguments, then the action the Draft indicates OIG plans to take – referral of the arrangements to the Department for a determination as to whether they involve illegal inducements – would be appropriate not only for those arrangements, but for the transactions addressed in Finding No. 1 as well. As noted above, the Draft’s recommendation that a penalty of more than $350 million be assessed for the latter transactions is unprecedented, unfair, and jeopardizes the ability of the FFELP to achieve its objectives.

Thank you very much for your careful consideration of this response. Please do not hesitate to contact us if you have any questions or would like to discuss this response in greater detail.

Attachments

\(^{20}\) Due to the combined effects on SLX of subsidy reductions enacted by the Congress and recent adverse credit market conditions, SLX recently made the decision to discontinue its origination of new FFELP loans. Accordingly, SLX has terminated the arrangements at issue.

\(^{21}\) The Draft contends that the transactions addressed in Finding No. 1 “differed structurally” from the arrangements addressed in “Other Matter” because the latter “did not name a third party, such as SLX, in the ELT agreement.” As demonstrated above, however, SLX’s role in the Trust Agreements was minimal, and, under longstanding ED policy and settled case law, can not justify ignoring the fact that these transactions involve the sale of consummated loans, not the payment of marketing compensation.
Appendix A

Seamus O'Neill Expert Report

I. Professional Background and Expertise. (See attachment 1)

II. At the request of Saul L. Moskowitz, as counsel to CIT, I have reviewed the Fifth Third Bank Draft Audit Report, ED-OIG, A09H0017, March 2008, as well as the documents listed below involved in the PLP/SLX arrangement. I have confirmed my understanding from Mr. Moskowitz that these documents also reflect the analogous documents in the MSA/SLX and LSF/SLX arrangements.

a. PLP Eligible Lender Trust Agreement, April 1, 2005
b. PLP Loan and Security Agreement, April 1, 2005
c. PLP Student Loan Forward Commitment Sale/Purchase Agreement, April 1, 2005
d. PLP Consolidation Loan Origination and Servicing Agreement, April 1, 2005
e. PLP Administration Agreement, April 1, 2005

III. Observations and Opinions:

a. The Draft's recommendation calls into question the guarantee and subsidy payments on tens of billions of dollars in loans held by other lenders all over the country. At a time when the program may well be on the brink of collapse due in substantial part to the lack of confidence of the credit markets in the suitability of FFELP loans as investments, the Draft would inject a major new source of risk and uncertainty for current and potential investors in securities backed by such loans. In fact, merely including the recommendation to unreinsure the loans at issue in the Final Audit Report would likely create a major obstacle for FFELP lenders trying to locate the financing they need to refinance existing loans and continue to make loans.

b. The structure of the transactions at issue is commonplace in the FFELP, and, in terms of economics and the rights and obligations of the parties, indistinguishable in all material respects from transactions under which tens of billions of dollars in FFELP loans have been made by numerous lenders over the years, and particularly since the Riley decision in 2000. In particular, in the course of my work, I have assisted FFELP participants...
in creating and/or reviewing numerous transactions involving billions of dollars in loans under which former marketers that have become FFELP lenders have, through eligible lender trust arrangements, operated as full-fledged FFELP lenders. Some of these structures have involved an established FFELP holder providing financing, origination and disbursement servicing, and a commitment to purchase the loans involved promptly after disbursement.

c. Each of the component agreements in the transactions at issue, and the benefits derived therefrom for the Lenders, are traditional, customary, and unremarkable.

d. This includes in particular the provisions in the Trust Agreements requiring the loans to be funded with funds borrowed by the Lenders from a specific reliable liquidity provider, originated and serviced by a specific experienced third-party servicer, and subject to sale promptly after disbursement under a forward purchase and sale commitment with a specific well-established loan holder. Prudent ELTs, financing providers, and loan purchasers routinely require such restrictions, especially when the beneficial owner is new or relatively new to the lender role. These provisions give the parties confidence that loans in the trust are properly funded and serviced, and are committed for sale to a reliable FFELP loan purchaser prior to the first payment due date (when administration of a loan becomes substantially more complicated).

e. Many FFELP lenders, including some of the largest in the program, started as marketers. Most new FFELP lenders first embark on that role via relationships with established FFELP industry participants like SLX that are substantively indistinguishable from those involved here.

f. The Lenders' roles as debtor and loan seller in the transactions at issue require them to accept substantial obligations not required of mere marketers – the types of obligations, in fact, that have led other marketers to decide not to become lenders.

g. Compensated marketers have long been the norm in the industry.

h. In a Federally guaranteed loan program, which depends upon voluntary participation by private financial institutions, it is essential that those institutions be able to rely on the Federal guarantee, and consistent application of laws and regulations over time. Consistent treatment of like financing and loan origination structures by the government makes the financing of loans possible. Inconsistent treatment will have the opposite effect.
I. Resume – Seamus O’Neill

Professional Experience

1/1988 to the present  Managing Partner, Liscarnan Solutions, LLC

Oversees the firm’s financial advisory and consulting services. Liscarnan’s primary focus is structured financings and securitizations for student loan industry. Additionally, for the several years Liscarnan and its predecessor company, Kohne O’Neill, LLC, have expanded their consulting services to include student loan business development and corporate growth advice and services. These activities, fostered by Mr. O’Neill, focus primarily on the development of student loan marketing and loan origination activities for clients.

9/1998 to the present  Partner of Kohne O’Neill, LLC

Kohne O’Neill is a student loan asset and program management company devoted to the origination, financing and administration of student loan assets and their related structured financings.

8/1983 to 12/1987  Principal, Donaldson, Lufkin & Jenrette

Specialties included structuring and underwriting of debt for project financings, healthcare and higher education, and student loans. Developed the first taxable/tax-exempt hybrid financing for student loans.

2/1983 to 7/1983  Vice President of Lehman Brothers Kuhn Loeb

Focused on student loans and general public finance investment banking. Developed the first commercial paper financing for student loans.
10/1981 to 1/1983  
Vice president, Shearson American Express, Inc.  
Focusing on the development and underwriting of structured debt for student loans, healthcare and higher education. Developed the first successful variable rate financing for student loans.

8/1979 to 3/1981  
Associate, AG Becker Incorporated  
Focused on general investment banking, including: mortgage finance, student loans, healthcare, and debt restructuring. Worked on the first debt financing supported solely by student loan revenues.

8/1977 to 7/1979  
Legislative economist and financing analyst  
Focused on state debt, capital expenditures and the financial markets. Developed the first analytical system for forecasting future revenue and expenditure impact of state legislation.

10/1976 to 7/1977  
Bond Market Analyst, Illinois Governor's Budget Office  
Developed the first information system for tracking state general obligation and state related debt. Prepared state general obligation debt offerings.

Economist, Illinois General Assembly  
Focused on program evaluation and the development of an econometric forecasting model for tax revenues.
Education

1980 to 1982  Graduate School of Business
             University of Chicago
             Various courses in business, accounting and finance at the University of
             Chicago Graduate School of Business

             Master of Arts in economics
             Ph.D. candidate in economics with specialty fields in public finance,
             urban economics and econometrics

9/1970 to 8/1972  State University of New York at Geneseo
             Bachelor of Arts, economics, cum laude

9/1969 to 6/1970  University of Southern California
### Professional Activities

<table>
<thead>
<tr>
<th>Date</th>
<th>Event Details</th>
</tr>
</thead>
<tbody>
<tr>
<td>3/21/2007</td>
<td>Investment community presentations in Boston</td>
</tr>
<tr>
<td></td>
<td>&quot;Proposed Changes to the Higher Education Act and the Impact on the Student Loan Industry&quot;</td>
</tr>
<tr>
<td>3/20/2007</td>
<td>Investment community presentations in New York</td>
</tr>
<tr>
<td></td>
<td>&quot;Proposed Changes to the Higher Education Act and the Impact on the Student Loan Industry&quot;</td>
</tr>
<tr>
<td>11/8/2005</td>
<td>Investment community presentation in New York City</td>
</tr>
<tr>
<td></td>
<td>&quot;Private Student Lending – Industry Outlook and Analysis&quot;</td>
</tr>
<tr>
<td>7/22/2005</td>
<td>Investment community presentation in San Francisco</td>
</tr>
<tr>
<td></td>
<td>&quot;Private Student Lending – Industry Outlook and Analysis&quot;</td>
</tr>
<tr>
<td>1/14/2004</td>
<td>Presentation to the American Association of Medical Colleges at their annual Conference in Burbank, California</td>
</tr>
<tr>
<td></td>
<td>&quot;Consolidation Loans and How They Got That Way!&quot;</td>
</tr>
<tr>
<td>3/8/2001</td>
<td>Presentation to the Education Finance Council</td>
</tr>
<tr>
<td></td>
<td>&quot;The Future of Student Loan Secondary Markets&quot;</td>
</tr>
</tbody>
</table>

### Prior Expert Testimony

<table>
<thead>
<tr>
<th>Year</th>
<th>Case Details</th>
</tr>
</thead>
<tbody>
<tr>
<td>2002 and 2003</td>
<td>College Loan Corporation v. SLM Corporation, et al.</td>
</tr>
</tbody>
</table>
Appendix B

History of ED Interpretations Regarding Marketing Compensation

In the seminal Dear Colleague addressing inducement issues, ED stated that
the anti-inducements prohibition does not apply at all to payments made to support
"generalized marketing". Dear Colleague 89-L-129, at 2-3 (February 1989)
(distinguishing activities "undertaken to directly secure applications from
individual prospective borrowers" from "generalized marketing or advertising") (the
"DCL"). Referral fees, on the other hand, were expressly prohibited regardless of
how they were calculated. Id. at 2.

In a March 3, 1992, letter from Robert W. Evans of ED to Saul Moskowitz of Clohan
& Dean, Evans stated that proposed compensation for a lender's contractor to market the
lender's loans to schools based on applications generated by the marketer was prohibited
under the DCL, but an annual fixed fee could be paid for the contractor to engage in the
same activities. Moskowitz's March 13, 1992 response to Evans specifically
pointed to the "generalized marketing" vs "securing loans" distinction in the DCL and noted
that no distinction between performance-based compensation and a flat fee-based structure
could rationally be implied from the statute or the DCL. Moskowitz's letter stated as
follows:

If the [marketing] agent's activities fall within the marketing exception,
the lender is free to choose how to structure the agent's compensation.
Conversely, if the activities go beyond marketing to the point where they
involve securing applications, any form of compensation paid by the
lender to the agent violates the [FFELP statute]. In each of the
[proposed compensation structures] described in our letters, though, there
is no ambiguity as to the activities to be compensated -- in each case the
activities constitute marketing, not securing loan applicants.

In his June 11, 1992, response, Evans reversed his March 3 disapproval of the
compensation proposal at issue. Evans' June 11 letter unambiguously adopts the
rationale advanced in Moskowitz's March 13 letter quoted above. In particular, the June
11 letter stated as follows:

Based on your description of [the marketing contractor's] activities, they
appear to be acceptable general marketing activities. The lender's agent
may be reasonably compensated for these presentations [to schools] and
the Department does not prescribe the basis for the compensation.

(Emphasis supplied.)

Evans' June 11 letter does not even mention the fact that the compensation at issue in
that instance was "per application" rather than "per loan", even though the March 13 letter
to which it responded pointed that out. Accordingly, the June 11 Evans letter cannot be
read as endorsing such a distinction. Rather, its clear language, especially read in the context of the arguments to which it was responding, confirmed that, in accordance with the DCL, ED "does not prescribe the basis" for marketing compensation because marketing, as distinguished from referrals, does not constitute "securing applicants".

In 1995, after Evans's departure from ED, the Department abruptly, and without explanation, reversed its position. In a June 7, 1995 letter to Moskowitz, Pamela Moran at ED stated that "referral payments (including marketing fees) that are based on loans disbursed [are] a violation” of the anti-inducements prohibition”. Moran’s letter attempted to distinguish the June 11, 1992 Evans letter because that guidance addressed a proposal to compensate marketers based on applications received, rather than loans disbursed. However, as noted above, the June 11 Evans letter made no such distinction, but instead broadly disclaimed any authority for ED to “prescribe” marketing compensation. Moreover, Moran’s letter expressly treated marketing fees as a type of referral fee, contrary to the interpretation in the DCL clearly treating the two as separate and distinct.

The June 7, 1995 Moran letter caused an immediate uproar in the FFELP industry, which had long believed that, under the DCL, as well as the June 11, 1992 Evans letter, marketing fees were not “prescribed” by ED, and that, therefore, per loan marketing fees were permissible. On August 21, 1995, the Consumer Bankers Association wrote to ED's Assistant Secretary for Postsecondary Education objecting to the Moran letter. A number of individual program participants also contacted ED to request that the Moran letter be applied prospectively only, pointing out that they had relied on the June 11, 1992 Evans letter as authorizing the payment of marketing fees on a per loan basis. Dr. Joe McCormick of ED acknowledged in an August 15, 1995 letter to Daniel Lau of Law Access, Inc., that there had been “apparent confusion that existed in the past concerning this issue”, and agreed to apply the Moran interpretation only to loans made after that date.

Subsequent private letter and email guidance from ED extended the purported ban on per loan marketing fees to include fees paid on a per guaranteed application basis, and to fees paid on subsequent loan requests made pursuant to a Stafford Loan Master Promissory Note (MPN) with respect to which a per application marketing fee had already been paid.

Then, in 2002, ED ceased providing guidance to the public on the application of the anti-inducements prohibition to specific issues, instead simply stating in response to requests for such guidance that “the statute is clear”. In response to a request for clarification as to whether, in light of ED's view that the statute was clear, ED would reconfirm its original position in the DCL and the June 11, 1992 Evans letter that the statute does not cover marketing compensation. ED responded by reiterating that the statute was clear, and that no further guidance was needed.

One can readily reconcile ED's 2002 position that the statute is clear with ED's original interpretation as stated in the DCL -- i.e., that marketing is different from
"referring", does not constitute "securing applicants", and can be compensated as the parties see fit. However, ED’s post-June 1995 position cannot be reconciled with the notion that "the statute is clear". The plain language of the statute does not make distinctions based on the form of the payment or how it is calculated. See also DCL at 1 ("The Department believes these provisions were broadly intended to prohibit the direct or indirect offering or payment of any kind of financial incentive...regardless of the form of the incentive or its mode of payment."). Moreover, no reading of the plain language of the statute could support the contention that paying a fee per application is less aptly characterized as a payment in order to secure applicants than a fee paid per loan.

In 2003, ED reconsidered its refusal to provide guidance to the public on inducements questions and, at that point, indicated that it would return to its post-1995/pre-2002 view that marketing compensation paid on a per application/MPN basis is permissible, but compensation paid on a per loan or per guaranteed application/MPN basis is prohibited. ED officials have reiterated that position on various occasions thereafter.

ED’s 2007 inducements rulemaking created even more confusion on the marketing compensation issue. In ED’s June 12, 2007 Notice of Proposed Rulemaking (NPRM), ED stated that “[marketing] compensation or fees based on the number of applications ... are improper, regardless of label, under the Department’s current and prior policy and would continue to be improper under these proposed regulations.” 72 Fed. Reg 32424 (emphasis supplied). As the above recitation illustrates, except for a brief period in 1992, ED had never taken the position that per application marketing fees were problematic. When industry participants objected to the preamble statement, ED officials confirmed in various emails that, notwithstanding the preamble statement, its then-current policy permitted per application marketing compensation. However, the preamble to the final regulations published on November 1, 2007, did not retract the NPRM preamble statement -- and even claimed that it was the commenters that had mischaracterized current policy. However, the preamble also states that current policy permits “reasonable [marketing] compensation...based on applications referred but not on loans funded or disbursed.” 72 Fed. Reg. 61978.

Given the confusion caused by the preamble to the NPRM, the industry was hopeful that ED would use the November 1, 2007 final regulations to clearly and definitively address the marketing compensation issue. It did not. The final regulations prohibit “referral fees” but do not define that term. See 34 CFR 682.200 (definition of “Lender”, paragraph (5)(i)(A)(5)). The preambles to the NPRM and final regulations, read together, appear to contemplate that, beginning July 1, 2008, marketing compensation will not be permitted to be paid on a per application/MPN basis, but will be permissible if paid on a flat fee basis. ED officials have indicated by telephone that this is the case, and that “per lead” compensation will also be permissible, but ED has not yet responded to a request for written confirmation of that guidance submitted six (6) months ago. Thus, the marketing compensation issue remains muddled to this day.