May 26, 2009

Board of Governors of the Federal Reserve System
Attn: Jennifer J. Johnson, Secretary
20th Street and Constitution Avenue, NW
Washington, DC 20551

Re: Docket No.: R-1353

Dear Ms. Johnson:

Kaplan Higher Education Corporation ("KHEC") is pleased to comment on the proposed rules published by the Board of Governors of the Federal Reserve System that would amend Regulation Z which implements the Truth in Lending Act ("TILA") following the passage of the Higher Education Opportunity Act ("HEOA"). While KHEC is generally supportive of the principles that form the basis of the TILA amendments and the HEOA changes relating to private education loans, KHEC believes that the proposed rules should not apply to certain types of programs under which schools extend credit to students. Application of the proposed rules to the types of programs that are described below could have unintended negative consequences for student borrowers.

KHEC, a subsidiary of the Washington Post Company, provides a wide array of diploma and degree programs—on campus and online—designed to meet the needs of students seeking to advance their education and their careers. Kaplan's U.S.-based Higher Education business currently consists of 71 schools in 20 states that provide classroom-based instruction and one institution that specializes in online education. The schools providing classroom-based instruction offer a variety of diploma, associate's degree and bachelor's degree programs, primarily in the fields of healthcare, business, paralegal studies, information technology, criminal justice, and fashion and design. The classroom-based schools were serving more than 38,700 students at year-end 2008 (which includes the classroom-based programs of Kaplan University), with approximately 35% of such students enrolled in accredited bachelor's or associate's degree programs. Each of these schools is accredited by one of several regional or national accrediting agencies recognized by the U.S. Department of Education. Kaplan University specializes in online education, offering various master's degree, bachelor's degree, associate's degree and certificate programs, principally in the fields of management, criminal justice, paralegal studies, information technology, financial planning, nursing and education. Kaplan University is accredited by the Higher Learning Commission of the North Central Association of Colleges and Schools. Most of Kaplan University's programs are offered online, while others are offered in a

traditional classroom format at eight campuses in Iowa and Nebraska. At year-end 2008, Kaplan University had approximately 43,600 students enrolled in online programs.

KHEC applauds the Board for its efforts in adding more transparency to private education loans. Our comments focus on an issue involving the definition of private education loan, specifically whether certain extensions of credit by schools that do not involve the disbursement of funds to students are "private education loans" for purposes of the Board's proposed rules. As set forth below, we believe that the final rules should make clear that certain types of extensions of credit by schools to students should not be considered "private education loans" for purposes of the new disclosure rules.

KHEC's Payment Plan Programs

KHEC offers certain payment plans to students attending its 71 schools including a tuition payment plan which allows students to pay tuition and other approved charges in monthly installments with no finance charges. In our current economic environment, where private lenders have curtailed private educational lending, these plans provide a no-interest option for Kaplan students to pay for their education. Separately, students taking programs offered under Kaplan's Continuing Education Program ("KCE") have the opportunity to enter into retail installment sales agreements which allow the students to pay tuition in installments with a fixed per annum interest rate charged. KCE students are encouraged to pursue other financing options before they choose the KCE internal programs. The KCE programs are not Title IV eligible.

In the proposed rules, the Board has indicated that it intends to use Regulation Z's existing definition of "creditor" (12 CFR 226.2(a) (17) as the definition of "private educational lender." Under that definition a creditor is a person who regularly extends consumer credit (more than 25 times in the preceding calendar year). The Board has further stated that proposed 226.37(b) (5) would implement the HEOA's definition of a "private education loan." Proposed § 226.37(b) (5) defines a "private education loan" as a loan that:

(i) Is not made, insured or guaranteed under Title IV of the Higher Education Act of 1965 (20 U.S.C. 1070 *et seq.*);
(ii) Is extended to a consumer expressly, in whole, or in part, for postsecondary educational expenses, regardless of whether the loan is provided by the educational institution that the student attends; and
(iii) Does not include open-end credit or any loan that is secured by real property or a dwelling.

Extensions of Credit by Schools with no Finance Charges should not be Considered "Private Educational Loans"

KHEC respectfully submits that the Board should exempt from the definition of "private education loan," extensions of credit made by schools to students for tuition and other educational expenses that (i) do not involve the disbursement of funds to the student; and (ii) do not include a finance charge assessed against the student. The proposed regulations do not specifically address whether credit sales by schools to students are "private education loans," but the Board does state that the proposed rules would apply to any **creditor** as defined in 12 CFR 226.17(a) and that the proposed rules could apply "not only to depository institutions and finance companies, **but also schools that meet the creditor definition and extend private education loans to their students.**"(emphasis added)(74 Fed. Reg. at 12489)

Many schools extend credit to students to pay for tuition and other charges by issuing retail installment contracts or written payment plans to such students. The retail installment contracts or written payment plans, which are subject to state law requirements, contain the terms and conditions under which the students agree to repay the school for the extension of credit. As discussed below, the Board should make clear in the final rules that extensions of credit by schools to students to allow students to pay for tuition and other charges in installments without interest or finance charges, would not be considered a private education loan subject to the new disclosure rules. These extensions of credit by schools which do not involve the delivery of funds to the borrower are credit sales and not "loans" in the traditional sense.

Relevant Court Rulings

A number of courts have concluded that to be a "loan," one party must deliver a sum of money to another party. For example, in In re Grand Union Co., 219 F.2d 353, 356 (2d Cir. 1914), the Second Circuit Court of Appeals ruled that: "[A] loan, … is the delivery of a **sum of money** to another under a contract to return at some future time an equivalent amount with or without an additional sum agreed upon for its use; and if such be the intent of the parties the transaction will be deemed a loan regardless of its form." (emphasis added). In a number of more recent decisions, courts have reiterated that a loan must include the delivery of a sum of money. See, e.g., Humboldt Bank v. Gulf Insurance Co., 323 F.Supp.2d 1027 (N.D. Calif. 2004)("[a] loan is a contract by which one delivers a sum of money to another and the latter agrees to return at a future time a sum equivalent to that which he borrowed" (citations omitted); Odell v. Legal Bucks, LLC, 665 S.E.2d 767 (N.Car. 2008)(**citing** North Carolina cases defining "a loan as a delivery or transfer of a sum of money to another under a contract to return at some future time an equivalent amount with or without an additional sum being agreed upon for its use). In the context of interpreting the term "educational loan" for purposes of Section 523(a)(8) of the Bankruptcy Code, the courts have not been consistent. For example, in In re Renshaw, 222 F.3d 82 (2d Cir. 2000) the court concluded that a school's enrollment agreement which specified tuition charges with an obligation to pay a service charge if payments not made by their

due date did not meet the classic definition of loan and was therefore outside of Section 523(a) (8) of the Bankruptcy Code. By contrast, in Merchant v. Merchant, 958 F.2d 738 (6th Cir. 1992), the court held that a private educational institution's extensions of credit to students for educational expenses were educational loans for purposes of Section 523(a) (8).

While a school that extends credit to students pursuant to a written agreement that allows payment in more than four installments may meet the technical definition of "creditor" under the existing TILA definitions (Sections 226.1(c), 226.2(a) (2) (17) and 226.2a) (14)) even when it does not charge interest to the students, the school is not making private education loans in the traditional sense. More importantly, the burden and expenses of applying the new disclosure rules to such "credit sales" that would be assumed by the school are not outweighed by the benefit to the consumer. The goal of consumer protection that is the underpinning of the proposed new disclosure rules would not be undermined by excluding credit sales which do not include finance charges from the definition of "private education loan" and, in any event, subjecting such credit sales to the new disclosure rules would not provide any meaningful benefit to consumers. Rather, consumers would likely be confused to receive multiple disclosures on a simple credit sale with no finance charges. .

Many of the new disclosures required at the application, approval and consummation stages would make no sense in the context of an installment payment plan provided by a school where there is no interest charged to the borrower. For example, the three day right to cancel before funds can be disbursed required under proposed Section 226.39(b) has no application to a credit sale which does not involve any disbursement of funds. Similarly, the requirement in proposed Section 226.39(e) that the borrower sign a self certification form that can be obtained from the school before the private education loan can be disbursed makes little sense when the school is the lender. Further, the requirement that borrowers be given 30 calendar days to accept the terms of the loan following notice of loan approval in proposed Section 226.38(b)(5) would be particularly problematic for schools to comply with, given that many schools require students to pay tuition and fees in full at the beginning of an educational term. This requirement is also troublesome for online education, where Kaplan is working with adult students who have made their decision and they wish to proceed in a timely fashion. The 30 day acceptance period is far more relevant for a student who is offered an adjustable rate loan tied to an index, where the monthly payment could dramatically change based on the movement of the underlying index.

Increases and decreases in the credit extensions will be made more difficult for our students because of the 30 day acceptance period. In your notice, you mention that the Board wants to balance consumer concerns with flexibility, and it seems that once a student has entered into the credit extension, they have made the decision to proceed, and future increases and decreases should not be subject to the new disclosure rules. This approach seems to unnecessarily delay the process for existing students.

A number of the required disclosures in the proposed rules address the maximum possible interest rate and the maximum monthly payment based on the maximum rate of interest for the loan. These have no application to a credit extension by a school with no interest being charged and would only serve to confuse students. In addition, as discussed below, these disclosures would be redundant for the fixed rate installment plans we offer to KCE students. Finally, proposed section 226.39(f) would require creditors with preferred lender arrangements with a covered institution to provide the covered institution with certain disclosures for each type of private education loan that the lender offers to students attending the covered institution. If credit sales by schools are considered "private education loans", the covered institution would have an obligation to provide itself with information about its own credit sales. Clearly, this would be entirely unnecessary. The additional disclosures have the potential to increase Kaplan's costs for providing this service, and in turn, increase the costs for our students. If schools that provide installment payment plans with no interest are forced to comply with the new disclosure requirements, they may be forced to either charge interest to students or even eliminate their interest-free tuition payment plans.

Retail Installment Agreements with a Fixed Interest Rate should be Excluded from the Definition of "Private Educational Loan"

KHEC also submits that credit extensions by schools to students for tuition and other charges that are documented by a retail installment sales contract and do include a finance charge assessed to the borrower should not be deemed "private education loans" for purposes of the new disclosure rules, because even where interest is charged, these credit extensions are not loans in the traditional sense, as a number of courts have recognized. Excluding such retail installment contracts from the definition of private education loan would not harm students and would relieve schools of an additional compliance burden that would not provide real benefits to students. The retail installment contracts would be subject to the existing TILA disclosure rules which should be sufficient given that no funds are disbursed to the student. Moreover, the existing state retail installment statutes provide ample disclosures to borrowers signing such retail installment contracts For example, the New York Retail Installment Sales Act requires retail installment contracts to contain the entire agreement of the parties with respect to the goods and services contracted for, including the names of the parties, their places of business, TILA disclosures, and a proviso regarding contracts paid in unequal installments, and to give specific notice to buyers, such as that they are entitled to a full(deleted y) copy of the agreement and that they have the right to pay off in advance the full amount contracted for. (N.Y. PERS. PROP. LAW § 402.) Students typically enter into retail installment sales agreements through the financial aid office at the school, and students have been counseled by the financial aid office on federal loans and grant opportunities. Requiring additional disclosures beyond the existing state law and TILA disclosure requirements would simply confuse students. Further, as noted above, the 30 day

acceptance period would be difficult to implement for schools that typically do not admit students who have not decided how to pay tuition charges.

<u>If Extensions of Credit by Schools are considered "Private Educational Loans" Certain Disclosures should not be Required</u>

If the Federal Reserve includes extensions of credit in the definition of "private education loans," KHEC respectfully submits that certain of the new requirements proposed in the draft regulations should be deemed inapplicable to such extensions of credit. Namely, the student's right of rescission within three days of consummation of the loan is inapposite in this context and the requirement that a student complete a self-certification form prior to consummation of the loan is redundant with existing safeguards. These requirements should not apply to extensions of credit by educational institutions which do not involve the delivery of funds to the borrower.

Proposed Section 226.38(c) requires final disclosures to be provided to the consumer after the consumer has accepted the loan and at least three business days before the loan is disbursed. Under proposed Section 226.39(d) these disclosures must include a statement that the consumer has the right to cancel a private education loan up to midnight on the third business day after receiving the disclosures, and the lender cannot disburse funds until the three-day period has expired.

According to the Notice of Proposed Rulemaking, the rationale for this requirement is as follows:

> The Board believes that the purpose of the final disclosure, and the consumer's three-business day right to cancel following receipt of that disclosure, is to ensure that consumers are given a final opportunity to evaluate their need for a private education loan after acceptance and before the funds are actually disbursed (74 Fed. Reg. at 12473).

This rationale simply does not apply to extensions of credit, because no "funds are actually [being] disbursed." Students entering into payment plans and retail installment contracts are simply being permitted to pay money due and owing to their schools in multiple installments instead of all at once. They are not receiving any funds, so they do not need a last chance to evaluate their decision to borrow. The three-day right of rescission in the context of credit extensions will slow down the process of providing credit to students without a countervailing benefit to students.

Proposed Section 226.38(a)(8) requires institutions to disclose, at the time of solicitation of a loan or application for a loan, that consumers will be provided with a self-certification form that they must complete, sign, and submit before the loan is consummated. Completion of the form is a requirement for all private educational loans under proposed Section 226.39(e).

According to the Notice of Proposed Rulemaking, the form will include information about the availability of federal student loans, the student's cost of attendance, the amount of financial aid, and the amount that can be borrowed to pay the cost of attendance (74 Fed. Reg. at 12465). The purpose of the form is to inform the consumer of his rights and obligations related to borrowing money to attend an institution. As explained above, when the institution is extending credit to the student, the rationale for compiling the self-certification form is dubious since the school's financial aid office which typically processes the payment plan or retail installment sales agreement has already counseled the student on the cost of attendance and federal grant and loan programs.

In the Notice of Proposed Rulemaking, the Board has stated that it intends to use comment 39(e)-1 to "clarify that the self-certification requirement would not apply to loans where the self-certification information would not be applicable" (74 Fed. Reg. at 12486). The examples given of such loans are consolidation loans and loans to students attending educational institutions that do not meet the definition of institutions of higher education. KHEC respectfully submits that extensions of credit by educational institutions to their students should be added to this list.

Thank you again for providing us with the opportunity to comment on the proposed regulations. Please contact me if you need further clarification on the comments above.

Sincerely,

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