



UNITED STATES DEPARTMENT OF EDUCATION

WASHINGTON DC 20202

February 1989

INDUCEMENTS PROHIBITED UNDER THE
STAFFORD LOAN, SUPPLEMENTAL LOANS FOR STUDENTS, PLUS,
AND CONSOLIDATION LOAN PROGRAMS

89-L-129

89-S-55

89-G-157

Dear Colleague:

The Higher Education Act of 1965, as amended (the Act), prohibits eligible lenders and guarantee agencies from offering or paying certain inducements in connection with loans made under Title IV, Part B, of the Act (Part B loans). A violation of these provisions may result in the offender's disqualification from further program participation, and/or other sanctions. The purpose of this letter is to provide lenders and guarantee agencies with guidance in complying with these provisions.

Prohibited Activities

The following provisions of the Act (effective October 17, 1986) prohibit the offering or payment of inducements by lenders and agencies:

Section 428(b)(3) Restrictions on Inducements, Mailings, and Advertising.

"A guarantee agency shall not...offer, directly or indirectly, premiums, payments, or other inducements to any educational institution or its employees in order to secure applicants for loans under this part...."

Section 435(d)(5) Disqualification For Use of Certain Incentives.

"The term "eligible lender" does not include any lender that the Secretary determines, after notice and opportunity for a hearing, has after [October 17, 1986]... 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...."

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 applicants for Part B loans, or by a guarantee agency to a school or affiliated entities or individuals for that purpose, regardless of the form of the incentive or its mode of payment. Payments by guarantee agencies to lenders and others not affiliated with schools are not inducements prohibited by these provisions, although the source of inducements paid to lenders by guarantee agencies are limited by statute and regulation. See 8428(b)(1)(H) of the Act; 34 CFR 682.401(b)(6).

Examples of Prohibited Inducements:

1. A lender employs a student at a school to act as the lender's representative for the purpose of persuading individual prospective borrowers to apply for a loan with the lender.
2. A lender employs a loan solicitor or sales representative who visits schools for the purpose of persuading individual prospective borrowers to apply for a loan with the lender.
3. A lender pays another lender a "referral" or "finder's" fee for loan applications referred to the paying lender, ostensibly to compensate the referring lender for administrative costs incurred in processing the applications and in advertising the availability of loans through the payee lender. The portion of the fee that exceeds reasonable compensation for the referring lender's processing of loan applications and advertising constitutes a prohibited inducement.
4. A lender pays a "processing" fee to another lender, but only if the applicant actually obtains a loan.
5. A guarantee agency provides computers to a school, or a lender provides computers or computer software to a school, at below market rental or cost.
6. A lender's promotional activities include providing borrowers the chance to win prizes if they apply for loans.
7. A lender prints and distributes school catalogs for a school at reduced cost, in order to induce the school to refer loan applicants to the lender.
8. A guarantee agency provides payments to a school or its affiliates to induce the school to participate in the agency's program or to increase the number of applications submitted to the agency.
9. A lender or guarantee agency performs, without appropriate compensation, functions that the school is required to perform under the Part B Programs, or pays the school to perform such functions.

Permissible Activities

Some financial incentives provided by lenders and guarantee agencies are expressly permitted by statute, and are therefore not subject to the statutory prohibitions quoted above. Other activities provide some financial benefit to prohibited recipients of inducements, but are nevertheless permissible because the financial value of the benefit is nominal, or the activity is not undertaken to directly secure applications from individual prospective

borrowers, but rather as a form of generalized marketing or advertising. In addition, we do not believe these provisions were intended to prevent lenders and guarantee agencies from attempting to do a better job than their competitors in carrying out their established roles in the Part B programs, even if the improved service confers a financial benefit on schools or others.

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.
2. A lender declines to collect all or a part of the origination fee chargeable to the borrower. See §438(c)(2) of the Act.
3. A lender charges a borrower an interest rate that is lower than the statutory maximum. See §427A(f) of the Act.
4. A lender or guarantee agency establishes a toll-free telephone number for use by schools or others in obtaining information regarding Part B loans.
5. A guarantee agency provides training on the administration of the Stafford Loan Program to a school's employees free of charge, or provides written instructions or computer software to a school, to assist the school in completing forms required for the issuance of a Part B loan or otherwise transmitting the data required from a student, borrower, and/or school for that purpose. This type of activity is consistent with the agency's established rôle as the principal administrator of its program; it would not be considered a part of a lender's established role, which primarily involves completion of the lender portion of the application and the exercise of due diligence in making, disbursing, servicing, and collecting loans. Thus, a lender may, for example, speed up its processing of loan applications, perform additional loan-making or collection activities, or offer graduated repayment schedules, without violating the anti-inducement rules.
6. A lender or guarantee agency provides a school, free of charge, with counseling materials designed to provide a borrower with more comprehensive and detailed counseling than that required to be provided by the school.

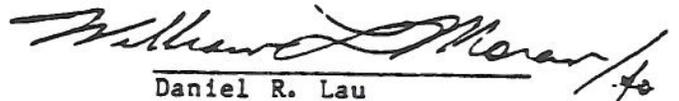
7. A lender or guarantee agency establishes a toll-free number for use by schools in electronically transmitting application or student status confirmation data to the lender or agency.
8. A lender or guarantee agency sponsors a luncheon for a recognized organization of schools or a school trade association, provides free pens with the lender's or agency's name inscribed thereon, or provides some other item of nominal value as a form of advertising or creation of good will, rather than as a quid pro quo for loan referrals.

Finally, lenders and schools are reminded that, under 34 CFR 682.212, no inducements may be paid to a lender or other party to secure funds for a school to use to make loans or to induce a lender to make loans to or on behalf of students at a particular school. We recommend that, before a lender or agency enters into an arrangement that it suspects may be prohibited by an anti-inducement provision of the Act or regulations, it contact the Department for guidance.

Sincerely,



Dewey L. Newman
Deputy Assistant Secretary
for Student Financial Assistance



Daniel R. Lau
Director, Student Financial
Assistance Programs