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What To Know About Ill. Student 'Know Before You Owe' Law

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Illinois H.B. 2746, also known as the Know Before You Owe Private Education Loan Act, was signed into law by Illinois Gov. J.B. Pritzker on Aug. 26, after unanimous passage in both chambers of the Illinois Assembly.

The act, which went into effect immediately upon signature by the governor, seems likely to pose significant compliance challenges for institutions of higher education that offer instruction to Illinois residents, student lenders and providers of income share agreements, or ISAs.

While the act commendably "aims to provide potential student borrowers with critical information, allowing them to make informed decisions about how to responsibly finance their education," it requires institutions of higher education to share specified student information with private educational lenders and ISA providers before any funds may be disbursed and it imposes new information reporting requirements on private educational lenders and institutions of higher education.

Applicability of the Act

The act applies to institutions of higher education, private educational lenders and student financing companies.

Institutions of higher education are defined in the act as including anyone "engaged in the business of providing postsecondary education ... to a person located in this State." Accordingly, educational institutions located outside of Illinois may be subject to the act's requirements with respect to any student who resides in Illinois.

Significantly, the act acknowledges the growing popularity of income share agreements[1] by regulating them alongside traditional private education loans and defining private educational lenders as including ISA providers.

The act defines an ISA as "an agreement under which a borrower commits to pay a percentage of his or her future income in exchange for money, payments, or credits applied to or on behalf of a borrower. An income share agreement constitutes a loan and debt within the meaning of this Act."

The act further creates an entirely new category of student financing companies, which seemingly includes companies, including institutions of higher education, that extend credit for postsecondary educational expenses, where such credit is not a federal student loan, private education loan, ISA or loan secured by real property or a dwelling.

This newly defined category is presumably meant to apply to institutions of higher education and other providers of short-term zero-interest payment plans that are exempt from the definition of a private education loan under the Truth in Lending Act.[2] While various banks and bank affiliates are excluded from the definition of a student financing company, they are not excluded from the definition of a private educational lender.

Loan Certification Requirements

The act requires private educational lenders to request certification from institutions of higher education of certain information prior to disbursing private education loans or ISAs, including the student borrower's enrollment status, estimated cost of attendance at the institution of higher education and the difference between the cost of attendance and the student borrower's estimated financial aid.

Private education lenders may disburse private education loans prior to receiving the required certification only if they first notify the institution of higher education in writing of the amount of credit extended to the student borrower and report the disbursement to the student loan ombudsman.

The immediate effective date of the act, coupled with the current lack of any established reporting mechanism, means that private student loan providers may be both unable to obtain timely certification and unable to comply with the reporting requirements, and some private student lenders may choose not to disburse students' loans rather than risk violating the act.

Until these matters are resolved, students may find themselves unexpectedly unable to finance their educations.

Institutions of higher education are obligated to provide the requested certification within 15 days of receipt from a private education lender, or must inform the lender that the institution will either need additional time to comply or is refusing to certify the loan.

Per the new law, prior to providing the certification, institutions of higher education must first determine whether the student borrower has exhausted available federal financial aid and, if not, inform the student borrower accordingly and provide information and disclosures to the student borrower about:

- The amount of federal financial aid for which the borrower is eligible;
- "The advantages of federal loans ... including disclosure of income driven repayment options, fixed interest rates, deferments, flexible repayment options, loan forgiveness programs, additional protections, and the higher student loan limits for dependent borrowers whose parents are not eligible for a Federal Direct PLUS Loan";
- The impact of a private education loan on the borrower's eligibility for federal financial aid; and
- The student borrower's right to select a private education lender of the student borrower's choice and to reject or cancel the private student loan.

The requirement that certification expressly include the student's estimated cost of attendance and financial aid, information that is generally not included in current private student loan certification processes, will require impacted institutions of higher education and private education lenders to update their loan certification processes.

Indeed, institutions of higher education that do not participate in Title IV student loan programs may be entirely unable to fully calculate students' costs of attendance or estimated financial aid.

Furthermore, institutions of higher education will be required to provide disclosures to student borrowers who have not exhausted their available financial aid, and these disclosures must describe

the advantages of federal loans.

Ensuring the accuracy of such disclosures in the continually evolving student loan market is likely to prove extremely challenging to many institutions of higher education, particularly as the required disclosures may not always be true for all students.

For example, certain private loans can be more advantageous to student borrowers than certain federal loans in certain circumstances, and not all private student loans can be canceled.

Quarterly Loan Statements

The act requires private student lenders to provide detailed loan statements to borrowers at least once every three months — i.e., quarterly — while they are in school, presumably so that borrowers can better understand how their private student loan obligations are increasing while they are still enrolled in school.

The act notably acknowledges the unique nature of ISAs by establishing a unique set of disclosure requirements, including a required disclosure of an annual percentage rate, or APR, for each of the student borrower's ISAs.

The APR disclosures are based on specified post-graduation earnings amounts equal to the annual minimum income above which payments are required, often referred to as a minimum income threshold, and for each $10,000 income increment above such amount, until the annual income at which the borrower would pay the maximum amount payable under the ISA, often referred to as the payment cap, in the maximum number of monthly payments that can be required, often referred to as the payment term.

Of concern is that these quarterly statements require ISA providers to disclose multiple APRs for the specified post-graduation incomes, regardless of whether such income amounts are remotely likely to occur.

As a result, these disclosures may anchor students' post-graduation income expectations at amounts that may be higher or lower than what most students can reasonably be expected to earn, which may skew such student borrowers' decision making with respect to their future educational borrowing.

Further, the APR disclosures do not represent the highest or lowest possible APR that borrowers can be required to pay under an ISA, which creates the possibility that student borrowers who end up paying an amount that results in an APR higher than the highest disclosed APR may feel deceived by the quarterly disclosures.

Reporting Requirements

The act imposes new reporting requirements on both private student lenders and educational institutions.

Private student lenders must submit an annual report to the Illinois Department of Financial and Professional Regulation and the student loan ombudsman that includes information regarding the schools at which the lender disbursed funds, the volume of loans made annually at each school, the historical lifetime default rate for borrowers obtaining covered loans and copies of exemplar documents provided to borrowers.

As discussed above, private student lenders must also report any private student loans disbursed without school certification.

Educational institutions must certify annually to the state Board of Higher Education and the Illinois Community College Board, where applicable, whether they have complied with the certification requirements set forth in the act.

Implications for Income Share Agreements

The act follows Illinois's 2019 Student Investment Account Act,[3] and these are the only laws in the country that expressly relate to ISAs.[4]

The Student Investment Account Act defines ISAs separately from loans, as "an agreement between a participant and an eligible institution of higher education or an income share agreement provider approved by the State Treasurer in which the participant agrees to pay a percentage of the participant's future earnings for a fixed period in exchange for funds to pay for their postsecondary education," and expressly authorizes the Illinois Treasurer's Office to offer and invest in ISA programs.

Thus, although both Illinois laws expressly acknowledge that ISAs may be offered in Illinois, the terminology and legal status of ISAs remain unclear.

Regulatory Guidance Is Necessary

The concerns expressed above highlight the need for regulatory clarification. Regulations should be adopted to clarify:

- The extent to which banks are exempt from the requirements of the act;
- The manner in which non-Title IV institutions of higher education can estimate students' estimated cost of attendance; and
- Safe harbor model disclosure forms should be published with respect to the quarterly statements and the required notices to student borrowers regarding the "advantages of federal loans." Such model disclosure forms should enable ISA providers to explain the APR disclosures to avoid the possibility of consumer harm.

In the interim, education providers and private student loan lenders should carefully review their certification and reporting processes to ensure compliance with the new law.

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[1] See, generally, Ritter, Dubravka and Webber, Douglas A., Modern Income-Share Agreements in Postsecondary Education: Features, Theory, Applications (2019-12-06). FRB of Philadelphia Payment Cards Center Discussion Paper No. 19-6. Available at SSRN: https://ssrn.com/abstract=3499957 or http://dx.doi.org/https://doi.org/10.21799/frbp.dp.2019.06.

[2] 15 U.S.C. § 1650.

[3] Illinois Public Act 101-0586, available online at https://www.ilga.gov/legislation/publicacts/fulltext.asp?Name=101-0586.

[4] A few state regulators have also issued formal or informal sub-regulatory guidance relating to ISAs.

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