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New Institutional Accountability Regulations – Borrower Rights and Financial Responsibility Requirements

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On Aug. 30, 2019, the U.S. Department of Education ("Department") announced[1] the unofficial release of final regulations amending the Borrower Defense to Repayment ("BDR") regulations ("2019 Regulations"[2]). The official version of the 2019 Regulations subsequently was published in the Federal Register on Sept. 23.

The 2019 Regulations modify in significant ways earlier BDR regulations published by the Obama administration on Nov. 1, 2016 ("2016 Regulations"[3]), but they retain important elements and concepts introduced in the 2016 Regulations as described in the summary of the new regulations provided by the Department. Despite some misconceptions to the contrary, the BDR regulations apply to all institutions that participate in the Title IV programs.

This article will focus on the material differences between the 2019 Regulations and the 2016 Regulations and the interplay between the two. Additionally, we will focus on five specific areas of the 2019 Regulations that institutions will find most important: (1) the definition of a borrower claim and the rules of the road surrounding those claims; (2) the use of mandatory arbitration agreements and class action waivers; (3) closed school and false certification discharges; (4) the impact on financial responsibility calculations; and (5) the treatment of leases in composite score calculations. Institutions are encouraged to consult with their legal

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counsel and auditors to determine how the provisions of the 2019 Regulations will impact them.

General information regarding the 2019 Regulations, changes from the 2016 Regulations and timing of implementation

The 2019 Regulations revise procedures and requirements under which borrowers of federal Direct Loans, including federal Direct PLUS Loans, and Direct Consolidation Loans can seek to have their loan repayment obligations reduced or even eliminated due to misrepresentation by institutions, institutional closures, and false certification by institutions of a borrower's eligibility for federal loans. The Department also has amended regulations regarding the calculation of financial stability composite scores and eliminated regulations that prevented the use by institutions of mandatory arbitration agreements and class action waivers, so long as institutions provide required disclosures and explanations.

Notably, all of the reporting obligations outlined in 34 C.F.R. § 668.171(h)[4] of the 2016 Regulations remain in place until the effective date of the 2019 Regulations. Institutions currently are required to report the following developments to the Department by email at FSAFRN@ed.gov, as detailed in the Department's March 15, 2019, guidance[5].

- Any litigation or administrative proceeding.
- An accrediting agency requirement for a teach-out plan related to a potential closure of the institution or one of its locations.
- Most withdrawals of equity from a proprietary institution with a composite score below 1.5.
- Failure of a proprietary institution to comply with the 90/10 rule in its most recent fiscal year.
- Certain actions by the Securities and Exchange Commission or trading exchanges regarding publicly traded institutions.
- The two most recent official cohort default rates exceed 30% unless certain appeal or challenge requirements are met.
- The institution is subject to any of a series of discretionary factors or events.

The 2019 Regulations are effective as of July 1, 2020. However, the Secretary of Education ("Secretary") exercised her discretion to allow early implementation of a small subset of the regulations dealing with the treatment of operating leases in the composite score calculation, as

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described under the "Treatment of operating leases in composite score calculations" heading.

Borrower claims

Key provisions of the new BDR regulations, which are applicable to new federal student loans first disbursed on or after July 1, 2020, are as follows (all section references to 34 C.F.R.):

- The Department has determined that a single federal standard will be used to make and decide all claims by borrowers. Under the singular federal standard, a claim must demonstrate (i) that "[t]he institution at which the borrower enrolled made a misrepresentation ... of material fact upon which the borrower reasonably relied in deciding to obtain a Direct Loan, or a loan repaid by a Direct Consolidation Loan, and that directly and clearly relates to: (A) [e]nrollment or continuing enrollment at the institution or (B) [t]he provision of educational services for which the loan was made; and (ii) [t]he borrower was financially harmed by the misrepresentation." (685.206(e)(2).)
- Misrepresentation is "a statement, act, or omission by an eligible school to a borrower that is false, misleading, or deceptive; that was made with knowledge of its false, misleading or deceptive nature or with reckless disregard for the truth; and that directly and clearly relates to 1) enrollment or continuing enrollment at the institution or 2) the provision of educational services for which the loan was made." (685.206(e)(3).) Some examples of misrepresentation include:
  - actual licensure passage rates or employment rates differ materially from rates provided in the institution's marketing materials;
  - actual institutional rankings differ materially from rankings included in the institution's marketing materials or provided by the institution to national ranking organizations;
  - incorrect statements regarding accreditation or institutional certification; and
  - incorrect statements regarding transferability of credits, employability and earnings of graduates, cost of tuition and fees, and the nature of financial assistance available to students.
- Borrowers can make both affirmative and defensive claims, meaning that they can make claims whether or not their loans are in repayment or default. Claims must be made within three years after the borrower leaves the institution for any reason, including withdrawal or graduation. All claims will be considered under a "preponderance of the evidence" standard, meaning that the borrower must demonstrate that the claim is more likely than not to be true.

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- In a departure from the 2016 Regulations, the new regulations permit only individual, rather than group, claims. A borrower will file an application with supporting evidence, under penalty of perjury, including a statement of the financial harm suffered by the borrower as a result of the institution's misrepresentation. The Department will share the

borrower's application with the institution, which then will have an opportunity to respond and provide evidence to support its position. The institution's response and evidence will be provided to the borrower, who will have an opportunity to reply. The Department then will consider all of these materials, along with any relevant evidence in its possession that it shares with the borrower and institution, to reach a final, non-appealable written determination.

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- If a borrower's claim is successful, the Department will determine the extent of the financial harm suffered by the borrower.
  - This amount can be more or less than the amount claimed by the borrower and can be either full relief or partial relief, meaning an amount as determined by the Department up to the full amount of the federal loan. "Financial harm is the amount of monetary loss that a borrower incurs as a consequence of a misrepresentation . . . [and] does not include damages for nonmonetary loss, such as personal injury, inconvenience, aggravation, emotional distress, pain and suffering, punitive damages, or opportunity costs." (685.206(e)(4).)
  - The regulations make clear that financial harm (i) is not caused by the mere fact that the borrower took out a federal loan, (ii) is monetary loss not caused predominantly by economic or labor conditions, and (iii) cannot be the result of a borrower's voluntary decision not to work, to accept part-time employment, or to change occupations. Instead, financial harm can be demonstrated by such circumstances as unemployment not related to economic conditions, actual tuition and fees that differ significantly from tuition and fees that had been represented to the borrower, and the inability of the borrower to finish the program at the institution because the institution no longer offers a necessary component.
  - The amount of relief cannot

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exceed the amount of the loan and associated fees, as adjusted by any refund or other reduction in the amount owed by the borrower.

- In the event of a successful borrower claim, the Secretary may initiate proceedings to recover any relief awarded to the borrower from the institution. The Secretary will have up to five years from the date of final determination to initiate such proceedings.

Pre-dispute arbitration agreements and class action waivers

Significantly, the Department acted in the 2019 Regulations to eliminate the prohibition on the use of mandatory arbitration agreements and class action waivers as a condition of enrollment that was introduced in the 2016 Regulations. Beginning July 1, 2020, institutions again can require applicants for enrollment to agree to pursue claims against the institution only in arbitration, rather than in court, and to agree not to pursue such claims in a class action proceeding. Institutions that use such agreements and waivers must provide disclosures to applicants and students, as follows:

- The disclosures must be written in plain, straightforward language and explain clearly the conditions for enrollment.
- The disclosures must state that the institution cannot require a borrower (i) to participate in arbitration or any other internal dispute resolution process prior to filing a BDR claim or (ii) in any way to waive or limit his or her ability to file a BDR claim. The disclosures also must state that any mandatory arbitration proceeding tolls the three-year limitation period for a borrower to file a BDR claim.
- All disclosures must be in 12-point font and be provided, at a minimum, on the institution's admissions information webpage and in the admissions section of the catalog.

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Closed school and false certification discharges

The 2019 Regulations make changes to discharge procedures in the case of school closures and false certifications of eligibility for federal loans first disbursed on or after July 1, 2020:

- If a borrower is unable to complete the program because his or her institution has closed or is closing, the borrower has the choice to accept any teach-out opportunity or apply for a closed-school discharge.
- The discharge window is lengthened from 120 days to 180 days, so that a borrower may apply for closed-school discharge if the borrower was enrolled on the day the institution closed or if the borrower withdrew from the institution at any point in the 180 days prior to the institution's closure. The Secretary retains discretion to extend the 180-day period in the case of exceptional circumstances, such as the

institution's loss of accreditation, state authorization, or Title IV eligibility.
- The automatic closed-school discharge provision included in the 2016 Regulations will not apply to loans first disbursed on or after July 1, 2020.
- Borrowers who believe that their federal loans were falsely certified may file an application under penalty of perjury asserting their claim supported by appropriate evidence. A borrower will not qualify for a false certification discharge because the borrower is not a high school graduate if the borrower had previously provided a written attestation to the institution stating that the borrower is a high school graduate.

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Financial responsibility

The 2019 Regulations substantially revise the triggering events first introduced in the 2016 Regulations that could lead to a recalculation of an institution's financial responsibility composite score.
- The Secretary will determine that an institution cannot meet its financial or administrative obligations if one of the following mandatory triggering events occurs (668.171(c)):
  - After the end of the most recent fiscal year on which the Secretary has calculated a composite score, either (i) the institution incurs a liability from a settlement, final judgment or final determination arising from any administrative or judicial action, or (ii) there is a withdrawal of owner's equity from a proprietary institution with a composite score less than 1.5 by any means, including the payment of a dividend, except to an entity in the affiliated group on which the composite score was calculated occurs, and, as a result of the liability or withdrawal, the recalculated composite score is less than 1.0.
  - For a publicly traded institution, the SEC suspends or revokes the registration of the institution's securities or suspends trading of the institution's securities, the exchange on which the institution's securities are traded delists the securities because the institution is not in compliance with listing requirements, or the SEC does not receive required reports timely and has not granted an extension.
  - In the most recent fiscal year on which the Secretary has calculated a composite score, if the institution is subject to two or more discretionary triggering events described below, those events will be considered mandatory triggering events unless a triggering event is resolved before a subsequent event occurs.
- The Secretary may determine that an institution cannot meet its financial or administrative obligations if one of the following discretionary triggering events occurs (668.171(d)):
  - The institution's accrediting agency issues a show-cause order or similar action that could result in the loss of the institution's accreditation if not

resolved.

- The institution violates a provision or requirement in a security or loan agreement with a creditor that leads to a default, delinquency or other event that causes or enables the creditor to require or impose an increase in collateral, a change in contractual obligations, an increase in interest rates or payments, or other sanctions or penalties.
- The institution's state licensing or authorizing agency determines that the institution has violated an applicable state agency requirement, and the state agency intends to withdraw or terminate the institution's license or authorization if the institution does not take steps to come into compliance.
- A proprietary institution fails the 90/10 rule for one year.
- The institution has high dropout rates as calculated by the Secretary. This provision was introduced in the 2016 Regulations, but the Department has not yet developed a specific threshold or methodology for this calculation.
- The institution's two most recent official cohort default rates are 30% or greater, unless one or both rates have been appealed or challenged and (i) the appeal or challenge is still pending, (ii) the appeal or challenge reduces one or both rates below 30%, or (iii) the appeal or challenge precludes the rates from resulting in a loss of eligibility or provisional certification.

- The Secretary will recalculate the institution's composite score by taking into account the actual amount of liabilities incurred by the institution or withdrawals from owner's equity.
- The new regulations establish important obligations to report mandatory and discretionary triggering events following procedures to be established by the Secretary (668.171(f)):

The new regulations establish important obligations to report mandatory and discretionary triggering events following procedures to be established by the Secretary (668.171(f)):

- For any liability resulting from a settlement, final judgment or final determination, notice to the Secretary within 10 days after the date of written notification.
- In the case of withdrawal of owner's equity from a proprietary institution with a composite score less than 1.5:
  - For a capital distribution that is the equivalent of wages in a sole proprietorship or partnership, required notifications to the Secretary within 10 days after the Secretary's notice of determination that the composite score is less than 1.5, plus potential subsequent notices depending on the nature and size of the distribution.
  - For a distribution of dividends or return of capital, no later than 10 days after the declaration or approval.
  - For a related party receivable, no later than 10 days after the receivable occurs.
- For publicly traded institutions, notice to the Secretary no later

than 10 days after the event occurs.
- For specified accreditation actions, within 10 days of notice.
- For loan agreement violations, within 10 days after the event occurs.
- For state licensing or authorizing agency violations, within 10 days after notice from the agency.
- For failure to comply with 90/10, notice within 45 days after the close of the fiscal year in which the failure occurred, as currently required under 668.28(c)(3).

Treatment of operating leases in composite score calculations

The Department recognizes that a pending change promulgated by the Financial Accounting Standards Board ("FASB") soon will require that the total amount owed on most operating leases be carried as a liability on an institution's balance sheet, which will have a negative impact on such institution's composite score calculation. In order to ameliorate this impact, the 2019 Regulations specify that all leases entered into prior to Dec. 15, 2018, will continue to be treated for composite score purposes as they were treated prior to the FASB change. Only leases entered into after Dec. 15, 2018, will be treated as directed by FASB Accounting Standards Update 2016-02.

The Secretary designated the new composite score regulations at 668.172(d), as well as the composite score calculation instructions for proprietary and non-profit institutions found in Appendix A and Appendix B, respectively, to Subpart L of Part 668, for early implementation. Institutions with composite scores near 1.5 or that may be adversely impacted by the FASB change due to significant lease liabilities may benefit from early adoption. However, institutions should note that these provisions also impose new requirements regarding the treatment of long-term debt in the composite score calculation. Therefore, institutions are strongly encouraged to consult with their auditors and legal counsel regarding the advisability of early adoption of 668.172(d) and Appendix A or Appendix B, as appropriate.

Final word

The 2019 Regulations represent a major change in the regulatory oversight by the Department. The good news is that institutions have time to ready themselves since the effective date, minus a few limited exceptions, is July 1, 2020.

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Resources

1. https://www.ed.gov/news/press-releases/us-department-education-finalizes-regulations-protect-student-borrowers-hold-higher-education-institutions-accountable-and-save-taxpayers-111-billion-over-10-years
2. https://www2.ed.gov/policy/highered/reg/hearulemaking/2017/borrower-defense-final-rule.pdf
3. https://www.govinfo.gov/content/pkg/FR-2016-11-01/pdf/2016-25448.pdf
4. https://www.govinfo.gov/content/pkg/CFR-2018-title34-vol3/pdf/CFR-2018-title34-vol3-sec668-171.pdf
5. https://ifap.ed.gov/eannouncements/030719GuidConcernProv2016BorrowerDefensetoRypmtRegs.html