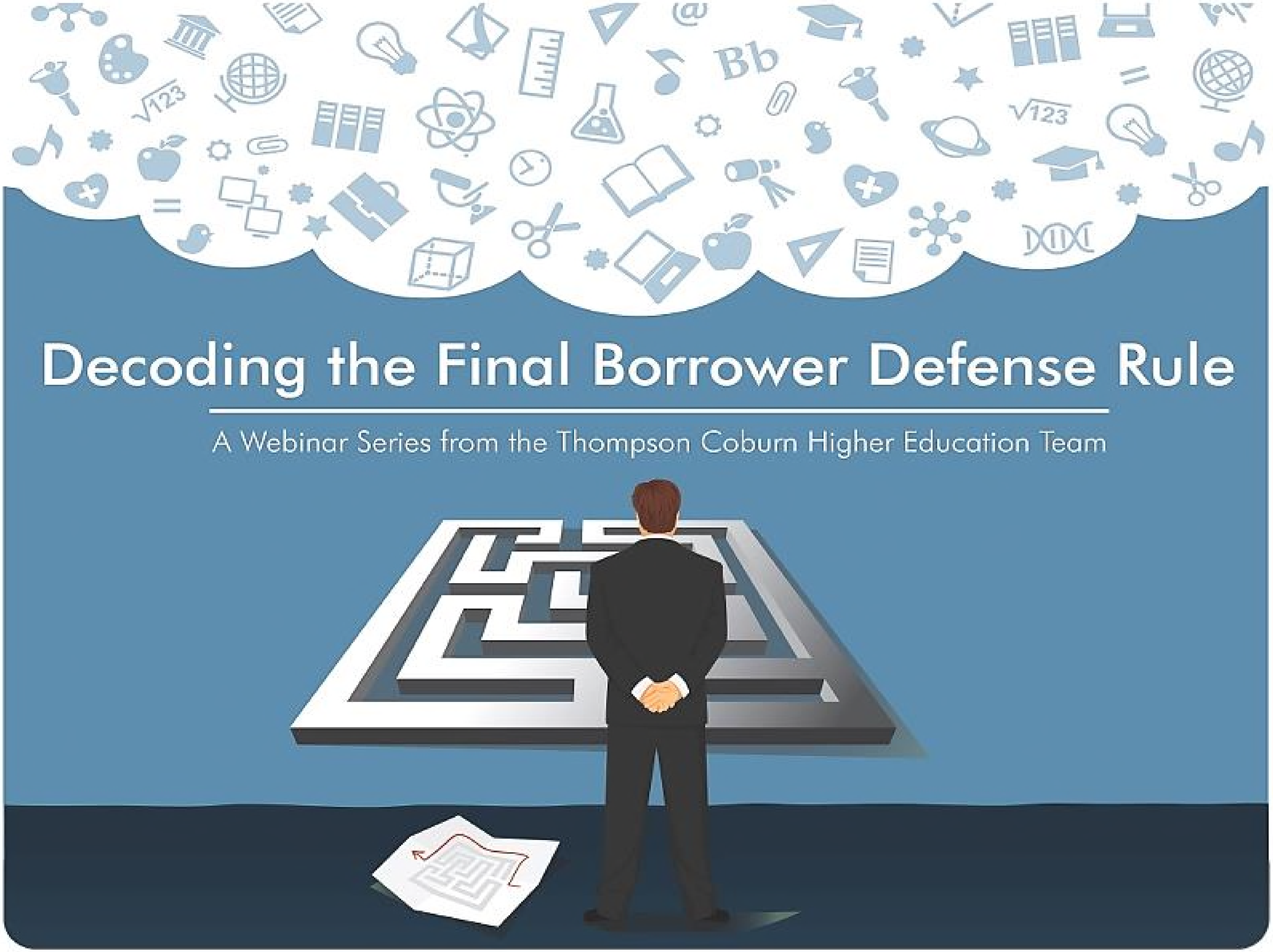
Decoding the Final Borrower Defense Rule

A Webinar Series from the Thompson Coburn Higher Education Team



Borrower Defense Webinar Series

- Webinar series schedule:
  - The New Borrower Defense Framework (November 29, 2016)
  - The Revised Financial Responsibility Standards (December 1, 2016)
  - Changes to Closed School and False Certification Discharge (December 6, 2016)
  - The Elimination of Pre-Dispute Arbitration Clauses and the New Repayment Rates for Proprietary Schools (December 8, 2016)

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WELCOME & INTRODUCTION

- Aaron D. Lacey
  - Partner, Higher Education Practice, Thompson Coburn LLP.
- Higher Education Practice
  - Provide regulatory counsel on federal, state, and accrediting agency laws and standards (*e.g.*, Title IV, Title IX, Clery, consumer information).
  - Assist with postsecondary transactions, contract drafting and negotiation, policy creation, and compliance systems design.
  - Represent institutions in student and employee litigation, government investigations, administrative proceedings, audits, and reviews.

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Welcome & Introduction

- Prior Experience
  - Senior Vice President of Regulatory Affairs & Strategic Development for postsecondary institution. Oversaw regulatory, compliance, and government affairs matters for 24 campus locations in Midwest and Southeast United States, as well as for online division.
  - Attorney in DC Higher Education Practice. Provided regulatory and policy guidance, managed agency proceedings, drafted and negotiated wide variety of agreements.

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Presentation Outline

- Politics & Prognostications
- The New Rule from 40,000 Feet
- Financial Resp. Fundamentals
- The New Financial Resp. Framework
  - Recalculating the Composite Score
  - Discussion of Select Automatic Triggering Events
  - Discussion of Discretionary Triggering Events
  - Process and Consequences
- TC Resources

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Politics & Prognostications

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Look Into My Crystal Ball…

Will this rule ever go into effect?

- The Congressional Review Act
  - Permits Congress to enact a “resolution of disapproval,” which if passed by both houses of Congress and signed by the President overturns any rule promulgated by a federal administrative agency.
  - Congress must act within 60 legislative days of a rule’s introduction.

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Look Into My Crystal Ball…

  - Sets an expedited legislative path, requires only a simple majority rather than the usual 60 votes needed to block a filibuster.
- Removal through rulemaking
  - ED can modify or remove the rule through the rulemaking process
- Suspension of enforcement
  - ED can simply determine not to enforce the rule

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Look Into My Crystal Ball…

- Congress will not act, nor will the White House, if the borrower defense rule is not a priority.
- The borrower defense statute and existing rule are already on the books, and will remain even if the new rule is struck down.
- Thousands of claims are being submitted, and will have to be dealt with through some process.

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The New Rule from 40,000 Feet

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Elements of the New Rule

Borrower Defense Framework

Financial Responsibility Triggers

Arbitration Agreements

Closed School Discharge

False Certification Discharge

Misrep-resentation

Repayment Rates for Prop. Schools

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Implementation Timeline

Date	2016 Rulemaking Events
Jan. – Mar.	• Negotiated rulemaking committee meets
June 16	• Proposed rules published
August 1	• Comment period closes
Nov. 1	• Publication of final rule in Federal Register*
July 1, 2017	• Effective date of new rule^

*Pursuant to Section 482(c) of the HEA, ED must publish final regulations before November 1 of a given year in order for them to take effect on July of the following year.

^Also pursuant to Section 482(c) of the HEA, ED has designated certain regulations for voluntary, early implementation by the regulated community, and elected to implement early certain requirements that are entirely the responsibility of ED.

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Financial Resp. Fundamentals

To begin and continue to participate in the federal financial aid programs, an institution must demonstrate that it is financially responsible.

- To this end, the HEA generally authorizes ED to establish “reasonable standards of financial responsibility.”

HEA § 487; 34 CFR §§ 668.14(4)-(5) and 668.171.

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Financial Resp. Fundamentals

More specifically, the HEA provides that these standards must assess whether an institution:

(1) Provides the services described in its official publications and statements.

(2) Provides the administrative resources necessary to comply with HEA requirements.

(3) Meets all of its financial obligations, including but not limited to refunds and repayments owed to ED.

HEA § 498(c)(1).

Financial Resp. Fundamentals

Pursuant to this authority, ED crafted the general standards of financial responsibility for private, non-profit and proprietary institutions located at 668.171.

- There is a separate standard for public institutions.
- Additional financial responsibility "factors" at 668.15 do not come into play here.

34 CFR § 668.171

Financial Resp. Fundamentals

Passing Composite Score	• Financial ratios must yield composite score of at least 1.5. 668.171(b)(1); 668.172.
Sufficient Cash Reserves	• Must have sufficient cash reserves to make required returns of unearned aid. 668.171(b)(2); 668.173.
Current in Debt Payments	• May fail in in violation of existing loan agreements or delinquent in debt obligations. 668.171(b)(3).
Meeting Financial Obligations	• Making all required refunds and payments of debts and liabilities to ED. 668.171(b)(4).
Clean Audit	• No qualified opinion or doubt about continued existence of institution. 668.171(d)(1).
Past Performance	• No violation of past performance provisions. 668.171(d)(2)); 668.174.

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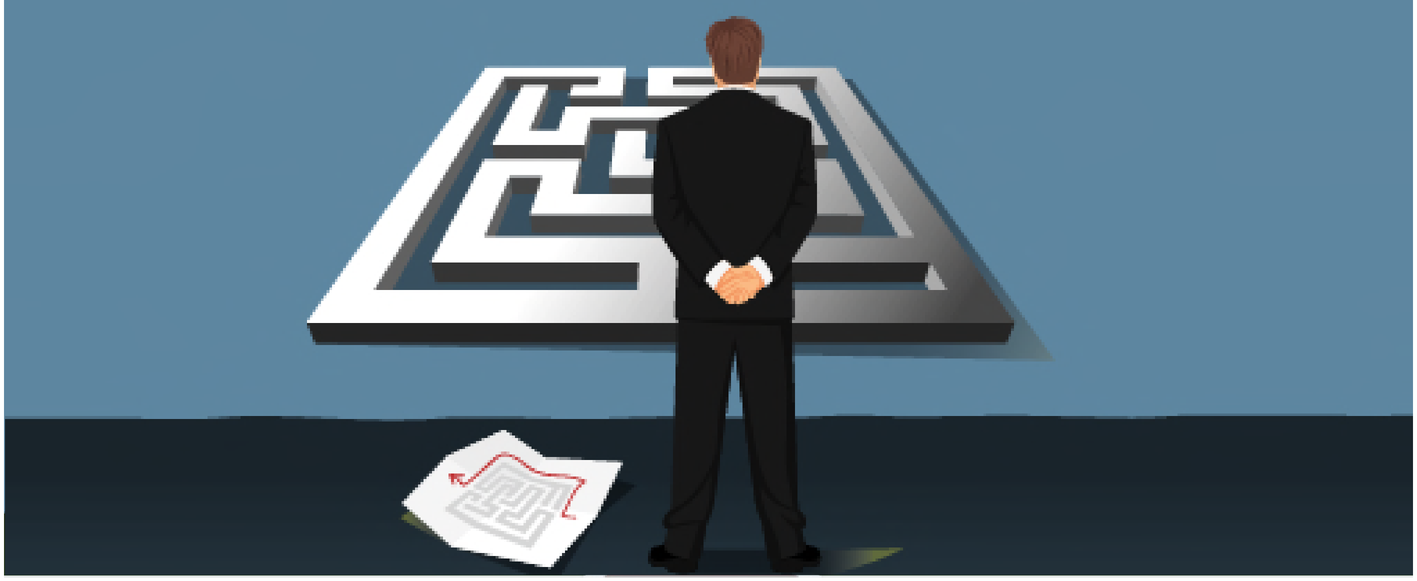
Financial Resp. Fundamentals

If ED determines an institution does not satisfy standards at 668.171, it may:

- Permit an institution to participate under an alternative standard under 668.175.
  - Letter of Credit, Zone, Provisional Certification
- Initiate a fine, limitation, suspension, or termination proceeding under Subpart G.
- For an institution that is provisionally certified, initiate “show cause” under 668.13(d).

34 CFR §§ 668.171(e).

The New Financial Responsibility Framework



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The New FR Framework

Passing Composite Score	• Financial ratios must yield composite score of at least 1.5. 668.171(b)(1); 668.172.
Sufficient Cash Reserves	• Must have sufficient cash reserves to return unearned aid. 668.171(b)(2); 668.173.
Meet Financial Obligations and Provide Administrative Resources	• Must meet financial obligations and provide administrative resources necessary to comply with financial aid requirements. An institution may not satisfy this standard if it is subject to one or more triggering events if they occur after July 1, 2017. 668.171(b)(3).
Past Performance	• No violation of past performance provisions. 668.171(b)(4)); 668.174.
Clean Audit	• No qualified opinion or doubt about continued existence of institution. 668.171(j).

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The New FR Framework

The final rule creates three classes of triggering events

"Automatic" triggering events for which a projected composite score would be calculated and used as the basis for a financial responsibility determination.	"Automatic" triggering events which, upon their occurrence, would automatically result in a finding of failed financial responsibility.	"Discretionary" triggering events that ED may elect to demonstrate will likely have a MAE on financial responsibility.
New 668.171(c).	New 668.171(d)-(f).	New 668.171(g).

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Actions and Triggering Events

Debts and BDTR-related lawsuits

Other litigation

Accrediting agency actions

Gainful employment

Withdrawal of owner's equity

90/10 Failure

Publicly Traded Institutions

Cohort Default Rates

"Discretionary" Factors or Events

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Addressing Materiality

- In all cases, institutions will have an opportunity to demonstrate that a triggering event:
  - No longer exists;
  - Has been resolved; or
  - That the institution has insurance that will cover part or all of the debts and liabilities that arise at any time from the event.
- For triggering events requiring a projected composite score recalculation:
  - Institutions may attempt to demonstrate that the event has had or will have no effect on the assets and liabilities of the institution when the composite score is recalculated.

New 34 CFR §§ 668.171(c)(2) and (h)(3)(iv).

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Process & Consequences

Triggering event occurs →

Institution must report event to ED (typically within 10 days) →

Institution may provide evidence that event is non-material

↓

As applicable, ED projects composite score impact of reported event →

If projected composite score is less than 1.0, or triggering event is "automatic," institution is no longer financially responsible

↓

Institution may participate under provisional certification →

Institution must provide financial protection to ED →

Institution must comply with "zone alternative" requirements

New 34 CFR §668.171.

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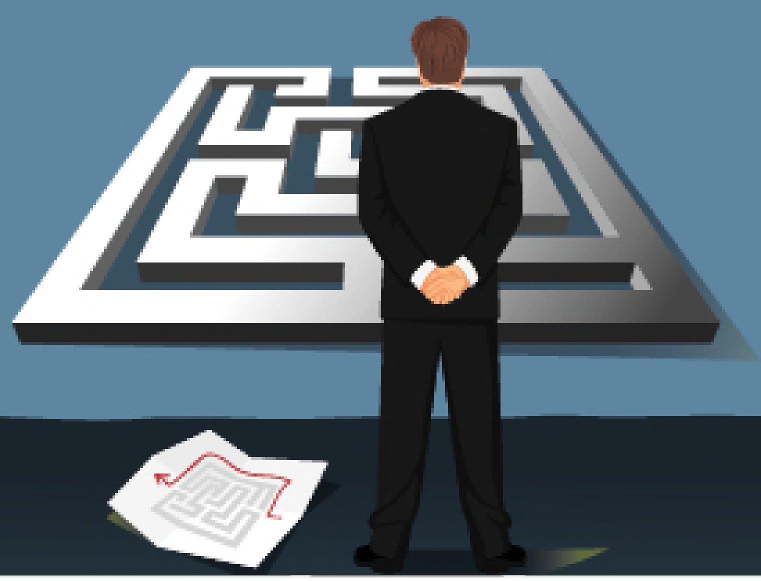
Recalculating the Composite Score



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Projecting the Composite Score

How is my composite score recalculated?

- Starting with the institution's most recent financial statements, ED "accounts for the actual or potential losses associated with the actions or events.. and, based on that accounting, recalculates the institution's most recent composite score."
- Additional detail regarding re-calculating methodology included in Appendix C to subpart L.

New 34 CFR § 668.171(c)(2).

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Projecting the Composite Score

Section 1: Proprietary Institutions

Event	Borrower-defense related lawsuits and other debts, §668.171(c)(1)(i)		Other Litigation, §668.171(c)(1)(ii)		Withdrawal of Owner's Equity, §668.171(c)(1)(v)		Accrediting Agency Requires Teach-out Plan for Closed Location, §668.171(c)(1)(iii)		Gainful Employment Programs, Loss of Eligiblity, §668.171(c)(1)(iv)	
Amount of Loss	Debt, relief claimed, or other amount as determined under §668.171(c)(2)(ii)		Relief claimed, or other amount as determined under §668.171(c)(2)(iii)		Total amount withdrawn, §668.171(c)(2)(iv)		Title IV funds received by the closed insitution or location during the most recently completed fiscal year, §668.171(c)(2)(iv)		Title IV funds received during the most recently completed fiscal year by GE programs in jeopardy of losing eligibility, §668.171(c)(2)(iv)	
Allowance for Expenses	Not applicable						Cost of Goods Sold (#28) / Operating Income (#25) multiplied by Amount of Loss			
	Entries for Loss Line item from Section 2, Appendix A						**Entries for Loss and Expenses** Line item from Section 2, Appendix A			
	Debit	Credit	Debit	Credit	Debit	Credit	Debit	Credit	Debit	Credit
Adjusting Entries	#32, Total Expenses		#32, Total Expenses		#23, Total Owners Equity		#27, Total Income		#27, Total Income	
		#13, Total Assets		#13, Total Assets		#13, Total Assets		#13, Total Assets		#13, Total Assets
	NA		NA		NA		#13, Total Assets (expense allowance)		#13, Total Assets (expense allowance)	
		NA		NA		NA		#32, Total Expenses (expense allowance)		#32, Total Expenses (expense allowance)

Projecting the Composite Score

Section 2: Non-profit Institutions

Event	Borrower-defense related lawsuits and other debts, §668.171(c)(1)(i)		Other Litigation, §668.171(c)(1)(ii)		Accrediting Agency Requires Teach-out Plan for Closed Location, §668.171(c)(1)(iii)		Gainful Employment Programs, Loss of Eligiblity, §668.171(c)(1)(iv	
Amount of Loss	Debt, relief claimed, or other amount as determined under §668.171(c)(2)(ii)		Relief claimed, or other amount as determined under §668.171(c)(2)(iii)		Tilte IV funds received by the closed insitution or location during the most recently completed fiscal year, §668.171(c)(2)(iv)		Title IV funds received during the most recently completed fiscal year by GE programs in jeopardy of losing eligibility, §668.171(c)(2)(iv)	
Allowance for Expenses	Not applicable				Operating expenses (#32) / Tuition & Fees (#27) multiplied by Amount of Loss			
	Entries for Loss Line item from Section 2, Appendix B				**Entries for Loss and Expenses** Line item from Section 2, Appemdix B			
	Debit	Credit	Debit	Credit	Debit	Credit	Debit	Credit
Adjusting Entries	#38b, Total Expenses (Unrestricted)		#38b, Total Expenses (Unrestricted)		#31b, Total Revenue (Unrestricted)		#31b, Total Revenue (Unrestricted)	
		#12, Total Assets		#12, Total Assets		#12, Total Assets		#12, Total Assets
	NA		NA		#12, Total Assets (expense allowance)		#12, Total Assets (expense allowance)	
		NA		NA		#38b, Total Expenses (expense allowance)		#38b, Total Expenses (expense allowance)

Debts and BD-Related Lawsuits

What is the triggering event?

- The institution is required to pay any debt or incur any liability arising from a final judgment in a judicial proceeding or from an administrative proceeding or determination, or from a settlement; or
- The institution is being sued in an action brought on or after July 1, 2017 by a Federal or State authority for financial relief on claims related to the making of the Direct Loan for enrollment at the school or the provision of educational services and the suit has been pending for 120 days.

New 34 CFR § 668.171(c)(1)(i).

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Debts and BD-Related Lawsuits

What is the reporting timeframe?

- For debts arising from lawsuits and for other actions or events, 10 days after a payment was required or a liability was incurred.
- For BD-related lawsuits, 10 days after the institution is served with the complaint and 10 days after the suit has been pending for 120 days.

New 34 CFR § 668.171(h)(1)(i).

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Debts and BD-Related Lawsuits

How is loss determined for BD-related lawsuits?

- It's the amount set by a court ruling, or, in the absence of a court ruling:
  - The amount of relief claimed in the complaint;
  - If the complaint demands no specific amount of relief, the amount stated in any final written demand issued by the agency to the institution prior to the suit or a lesser amount that the agency offers to accept in settlement of any financial demand in the suit; or
  - If the agency stated no specific demand in the complaint, in a pre-filing demand, or in a written offer of settlement, the amount of tuition and fees received by the institution during the period, and for the program or location, described in the allegations in the complaint.

New 34 CFR § 668.171(c)(2)(i)-(ii).

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Debts and BD-Related Lawsuits

What can an institution do to mitigate penalty?

- Demonstrate that the claimed amount exceeds the potential recovery because the allegations in the complaint, if accepted as true, and the claims asserted, if fully successful, cannot produce relief equal to the amount claimed (or the calculated exposure) because the allegations pertain to a period, program, or location for which the full recovery possible is a lesser amount.

New 34 CFR § 668.171(h)(3)(i).

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Accrediting Agency Actions

What is the triggering event?

- If the institution was required by its accrediting agency to submit a teach-out plan, for a reason described in § 602.24(c)(1), that covers the closing of the institution or any of its branches or additional locations.

New 34 CFR § 668.171(c)(1)(iii).

Accrediting Agency Actions

Teach-out plans are required if:

- ED initiates an emergency action or FLST proceeding against the institution and informs the accreditor that a teach-out plan is required.
- The accreditor acts to withdraw, terminate, or suspend the accreditation or preaccreditation of the institution.
- The institution notifies the accreditor that it intends to cease operations entirely or close a location that provides one hundred percent of at least one program.
- A State licensing or authorizing agency notifies the accreditor that an institution's license or legal authorization to provide an educational program has been or will be revoked.

34 CFR § 602.24(c)(1).

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Accrediting Agency Actions

What is the reporting timeframe?

- 10 days after the institution is notified by its accrediting agency that it must submit a teach-out plan.

New 34 CFR § 668.171(h)(1)(iii).

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Accrediting Agency Actions

How is loss determined for accrediting agency actions?

- For a closed location or institution… the amount of loss is the amount of title IV, HEA program funds the institution received in its most recently completed fiscal year for that location or institution.
- ED will recalculate the institution's composite score (1) based on the loss of title IV, HEA funds received by students attending the closed location during the most recently completed fiscal year, and (2) by reducing the expenses associated with providing programs to those students.

New 34 CFR § 668.171(c)(2); 81 Fed. Reg. 75993 (Nov. 1, 2016).

GE Programs

What is the triggering event?

- The institution has gainful employment programs that could become ineligible based on their final D/E rates for the next award year.

What is the reporting timeframe?

- No notification requirement applies in this instance. ED calculates the D/E rates.

New 34 CFR §§ 668.171(c)(1).

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GE Programs

How is loss determined for accrediting agency actions?

- For… the potential loss of eligibility for gainful employment programs… the amount of loss is the amount of title IV, HEA program funds the institution received in its most recently completed fiscal year for… those GE programs.
- ED will also recognize "the reduction in educational expenses associated with discontinuing those programs."

New 34 CFR § 668.171(c)(2); 81 Fed. Reg. 75995 (Nov. 1, 2016).

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Cohort Default Rates

What is the triggering event?

- The institution's two most recent official cohort default rates are 30 percent or greater, unless:
  - The institution files a challenge, request for adjustment, or appeal with respect to its rates for one or both fiscal years; and
  - That challenge, request, or appeal remains pending, results in reducing below 30 percent the official cohort default rate for either or both years, or precludes the rates from either or both years from resulting in a loss of eligibility or provisional certification.

New 34 CFR § 668.171(f).

Cohort Default Rates

What is the reporting timeframe?

- No notification requirement applies in this instance. ED calculates the official rates and will know.

What can an institution do to mitigate penalty?

- File a successful CDR appeal.

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Discussion of Discretionary Triggering Events

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Discretionary Factors or Events

What is the triggering event?

An institution is not financially responsible if ED demonstrates that there is an event or condition that is reasonably likely to have a material adverse effect on the financial condition, business, or results of operations of the institution, including but not limited too…

New 34 CFR § 668.171(g).

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Discretionary Factors or Events

1. A significant fluctuation in Direct Loan or Pell Grant funding that cannot be accounted for by changes in those programs.
2. The institution is cited by a State licensing or authorizing agency for failing State or agency requirements.
3. The institution fails a financial stress test developed by ED.

New 34 CFR § 668.171(g).

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Discretionary Factors or Events

4. The institution is or was placed on probation or issued a show-cause order, or placed on an accreditation status that poses an equivalent or greater risk.
5. The institution violated a provision or requirement in a loan agreement enabling 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, penalties, or fees.

New 34 CFR § 668.171(g).

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Discretionary Factors or Events

6. The institution has high annual dropout rates.
7. The institution has pending claims for borrower relief discharge.
8. ED expects to receive a significant number of claims for borrower relief discharge as a result of a lawsuit, settlement, judgment, or finding from a State or Federal administrative proceeding.

New 34 CFR § 668.171(g).

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Discretionary Factors or Events

What is the reporting timeframe?

- For State or agency citations, 10 days after the institution is cited for violating the State or agency requirement;
- For probation or show cause actions, 10 days after the accrediting agency places the institution on that status; and
- For violations of provisions or requirements in a loan agreement, 10 days after the violation occurs, the creditor waives the violation, or the creditor imposes sanctions or penalties in exchange or as a result of the waiver.

New 34 CFR § 668.171(h)(vii)-(ix).

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Discretionary Factors or Events

What can an institution do to mitigate penalty?

- Demonstrate that the triggering event:
  - No longer exists;
  - Has been resolved; or
  - That the institution has insurance that will cover part or all of the debts and liabilities that arise at any time from the event.

New 34 CFR §§ 668.171(h)(3).

Discretionary Factors or Events

- For violations of provisions or requirements in a loan agreement, demonstrate that the creditor waived the requirement.
  - However, if the creditor imposes additional requirements as a condition of the waiver, the institution must identify those requirements and demonstrate that complying will not adversely affect the institution's ability to meet its current and future financial obligations.

New 34 CFR §§ 668.171(h)(3).

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Process & Consequences

Triggering event occurs → Institution must report event to ED (typically within 10 days) → Institution may provide evidence that event is non-material

As applicable, ED projects composite score impact of reported event → If projected composite score is less than 1.0, or triggering event is “automatic,” institution is deemed no longer financially responsible

Institution may participate under provisional certification → Institution must provide financial protection to ED → Institution must comply with “zone alternative” requirements

New 34 CFR §668.171.

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Process & Consequences

What are the options for an institution found to lack financial responsibility?

- Provide financial protection equaling at least 50% of prior year T4 receipts.
- Participate under the Zone Alternative.
  - Only available to institutions that fail due solely to composite score.
  - Additional composite score, cash management, and reporting requirements apply.
  - Only available for three consecutive years.

New 34 CFR § 668.175(c)-(d).

Process & Consequences

- Provisional Certification
  - Provide financial protection equaling at least 10% of prior year T4 receipts.
  - Comply with the Zone Alternative (composite score, cash management, and reporting requirements).
  - To extend beyond three consecutive years requires additional guarantees.

New 34 CFR § 668.175(f).

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Process & Consequences

ED abandoned the stacking of financial penalties in the proposed rule.

> We agree with the commenters that an institution should not be required to provide financial protection for every automatic triggering event for which the underlying facts or circumstances are the same or where a direct causal relationship exists between two or more events...

81 Fed. Reg. 75984 (Nov. 1, 2016).

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Process & Consequences

Within 30 days of notifying ED of certain triggering events (TBD), an institution must:

- Disclose to enrolled and prospective students.
- Post disclosure on home page of website.

Disclosure must clearly "identify and explain" reason(s) institution was required to provide financial protection.

New 34 CFR § 668.41(i).

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TC Resources

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TC Resources

Our higher education law blog, *REGucation*.

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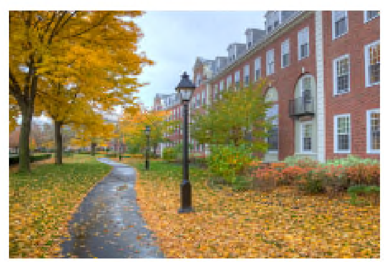
Title IX and due process: ED tells Wesley that accused student not treated fairly

Paul Stoehr Aaron Lacey November 2, 2016



In a rare move, the Department of Education announced on October 12, 2016, its determination that Wesley College in Delaware had violated Title IX by failing to provide appropriate procedural protections to a student accused of sexual misconduct. **READ MORE**

Contact Information

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