PROPOSED INSTITUTIONAL ACCOUNTABILITY REGULATIONS

Borrower Defense to Repayment

The Trump administration is proposing new standards and processes to address claims from borrowers for a discharge of their Federal student loans based on alleged misconduct by the postsecondary institution where they attended. The proposed regulations would create a clear, consistent, and transparent process for borrowers who have been harmed by their school's misconduct to seek debt relief. The regulations also create processes to allow schools to provide information to the Department during its consideration of the borrower's claim for a discharge, better protect the interests of taxpayers, and address the needs of students who paid cash or relied on other forms of credit to fund their education. In addition, the proposed regulations include measures that support prospective and enrolled students in their obligation to be informed consumers and responsible borrowers.

The Need for Course Correction

The Department first promulgated the Direct Loan Program's Borrower Defense to Repayment regulation in 1994. The Department's intent was for this rule to be effective for the 1995-1996 academic year and then to develop a more extensive rule for both the Direct Loan and Federal Family Education Loan (FFEL) programs through a negotiated rulemaking process. However, based on the recommendation of the non-Federal negotiators on a negotiated rulemaking committee convened in the spring of 1995 (60 FR 37768), the Secretary decided not to develop further regulations or to revise the existing borrower defense regulation found in § 685.206(c).

Though the regulation has been in effect since 1995, it was rarely used prior to 2015, when the Department received applications from borrowers for loan relief in response to the Department's announcement[1] that it would consider affirmative borrower defense claims. Prior to that announcement, an average of fewer than 10 claims were received each year. However, since 2015, the Department has received over 100,000 claims.

The regulation did not set forth the process a borrower may use to assert an affirmative borrower defense claim. However, the Department appointed a Special Master in June 2015 to create and oversee a process to provide debt relief for borrowers who sought Federal student loan discharges based on claims against the borrower's institution. Later, the Department's Federal Student Aid (FSA) office assumed responsibility for resolving these claims, and it continues to do so. This FSA process has proven to be burdensome to borrowers and costly to taxpayers, given the time it takes to adjudicate each claim.

From 2015 to 2016, the Department engaged in negotiated rulemaking on borrower defense. On November 1, 2016, the Department published final regulations, certain provisions of which have been delayed until July 1, 2019.

The Federal student aid programs are intended to provide all students with access to a high-quality postsecondary education. Current provisions in Federal law and regulations, called "defense to

[1] See ed.gov/news/press-releases/fact-sheet-protecting-students-abusive-career-colleges and studentaid.ed.gov/sa/about/announcements/corinthian.

repayment" or "borrower defense" provisions, allow Federal student loan borrowers to receive a discharge of their Direct Loans if their colleges' acts or omissions give rise to a cause of action under State law. The regulations proposed today would simplify and strengthen those provisions.

The proposed regulations would:

- Provide students with a balanced, directed process that relies on a single Federal standard rather than many different state standards to ensure that borrower defense to repayment discharges are handled swiftly, carefully, and fairly;
- Encourage students – including those who pay cash or use other forms of credit to pay for college – to seek remedies directly from institutions that have committed acts or omissions that constitute misrepresentation and cause financial harm to the student;
- Provide students with an additional 60 days (from 120 days to 180 days) to qualify for a closed school loan discharge and incentivize closing institutions to engage in an orderly teach-out process rather than suddenly shutting their doors;
- Ensure that institutions engaged in misconduct, rather than taxpayers, bear the burden of losses from borrower defense to repayment loan discharges;
- Enable institutions to respond to borrower defense to repayment claims and provide evidence to support their response;
- Discourage institutions from committing fraud or other acts or omissions that constitute misrepresentation;
- Enable the Department to properly evaluate institutional financial risks in order to protect students and taxpayers;
- Provide students who cannot obtain an official high school transcript or diploma the opportunity to receive federal financial aid and enroll by attesting, under penalty of perjury, that they completed high school, but disallowing such a borrower from later making a false certification student loan discharge claim if the borrower misrepresented the truth in their attestation;
- Provide time for the Department to consider engaging in negotiated rulemaking to update the Composite Score methodology to reflect changes in FASB accounting standards; and
- Maintain a strong, responsible Federal student aid system that can continue to provide redress for students who fall victim to misrepresentations by institutions.

Consideration of Alternatives

Although the Department has received well over 100,000 applications from borrowers seeking loan discharges since 2015, its experience with the defense to repayment process is still limited to a relatively narrow set of allegations against a small subset of institutions. Thus, the Department is seeking comment on the best and most fair process to students and taxpayers for loans disbursed on or after July 1, 2019.

In this request for public comment, the Department proposes two possible options for when a borrower can submit a borrower defense claim: 1) That the Department only accept "defensive" claims in response to a collection action, similar to the process described in the 1994 regulation; or 2) at the initiation of the borrower, similar to what has transpired since 2015, accept "affirmative" in addition to "defensive" claims. Because the implications of this determination are far-reaching for taxpayers and borrowers, the Department is seeking specific public comment on these alternatives and the conditions that would apply in each case, including elements of adjudication, such as the evidentiary standard and time limitations on a borrower to submit a borrower defense.

Summary of Major Provisions:

Clear, Transparent Processes for Borrowers

These proposed regulations would put in place a borrower defense process that is clear, understandable, and easily accessible for borrowers; that facilitates collection and review of evidence for deciding claims; and that ensures claims are processed efficiently, transparently, and fairly. The regulations would replace a complicated, uneven, and burdensome standard based on the application of the laws and procedures of the various states with a new Federal standard based on misrepresentation that would make relief available when there is a statement, act, or omission by the school to the borrower that is:

- false, misleading, or deceptive;
- made with knowledge of its false, misleading, or deceptive nature or with a reckless disregard for the truth; and
- directly and clearly related to the making of a Direct Loan for enrollment at the school or the provision of educational services for which the loan was made.

In order to be considered related to the "provision of educational services," a misrepresentation must be related to the borrower's program of study. Such misrepresentations can relate, for example, to the educational resources provided by the institution that are required by an accreditation agency or a State licensing or authorizing agency for the completion of the student's educational program. Such misrepresentations must have been relied upon by the student in making an enrollment decision, and must have caused the student financial harm.

Empowering Students to Make Informed Choices

These proposed regulatory changes also promote greater transparency by schools that require students to enter into pre-dispute arbitration agreements or class action waivers as a condition of enrollment. Such institutions must disclose these requirements to students, prospective students, and the public in an easily accessible format, and to provide the student borrower with written information on how to use the school's internal dispute resolution process. Such processes may enable students who took Federal loans, paid cash, or used other forms of credit the opportunity to have their complaints settled more quickly and to receive not only loan discharge, but potentially also compensation for financial losses and educational opportunity costs.

The Department's goal is to enable students to make informed decisions prior to college enrollment, rather than to rely on financial remedies after the fact when lost time cannot be recouped and new educational opportunities may be sparse. Postsecondary students are adults who can be reasonably expected to make informed decisions if they have access to relevant and reliable data about program outcomes. Institutions are prohibited from misleading students by providing false or incomplete information, and remedies should be provided to a student when misrepresentation on the part of an institution causes financial harm to that student. However, students also have a responsibility when enrolling at an institution or taking student loans to be sure they have explored their options carefully and weighed the available information to make an informed choice.

The Department has an obligation to enforce the Master Promissory Note, which makes clear that the student is not relieved of his or her repayment obligation if later they regret the choices they made. And while the Department wishes to protect borrowers from misrepresentation and fraud, the

Department also wishes to ensure that programs that have not engaged in misrepresentations are not forced to pay unsubstantiated claims that may result in diminished academic offerings or outright closure. For these reasons, these regulations provide institutions with an opportunity to respond to student claims and provide evidence to support that response, including necessary elements of student records.

Closed School Discharge

The increased number of school closures in recent years has prompted the Department to review regulations related to closed schools and to propose changes to them. Under the current regulations, students who are enrolled at institutions that close, as well as those who left the institution no more than 120 days prior to the closure, are entitled to a closed school student loan discharge provided that the student does not transfer credits from the closed school and complete the program at another institution. To ensure that borrowers who left an institution in the semester prior to its closure do not lose eligibility for closed school discharge because of a summer break, the NPRM proposes to expand the closed school discharge window from 120 days to 180 days prior to the school's closure.

The proposed regulations would also incentivize schools to provide students with an opportunity to complete their program through an approved teach-out opportunity that takes place at the closing institution or at another institution. Under the proposed regulations, the teach-out opportunity must be approved by the school's accreditor and, if applicable, the school's State authorizing agency. Under the proposed regulations, a borrower given the opportunity to complete his or her program through an orderly teach-out at a closing institution, or through an agreement with another institution, would not be eligible for a closed school loan discharge as long as the terms of the teach-out plan were met by the institution. This would add to the existing regulations, which also disallow students who transferred credits from the closed school to another school, or who finished the program elsewhere, to qualify for the closed school loan discharge.

Although final regulations published on November 1, 2016, and since delayed until July 1, 2019, included an automatic closed school loan discharge for eligible borrowers who did not re-enroll within three years of their school's closure, upon further consideration, the Department has determined that this could have unintended consequences for students because a school, or the custodian of its student records, is permitted to and might withhold the official transcripts of borrowers who received a closed school discharge. Although the 2016 regulation included an opt-out provision, students who miss the notification (perhaps due to a change in email or mailing address) or who do not fully understand the opportunity or its potential consequences, could be forced into participating in an action that could prevent them from verifying their credits or credential in the future. Therefore, the proposed regulations would require borrowers to submit an application in order to receive a closed school loan discharge.

While the automatic closed school discharge may have benefited some students who would no longer need to submit an application to receive relief, it may have disadvantaged other students who wish to continue their education at a later time or provide proof of credit completion to future employers.

The expansion of the eligibility period would increase the number of students eligible under this criterion and encourage institutions to provide opportunities for students to complete their programs in the event that a school plans to close. It will also encourage institutions that are moving toward a school closure to work with accreditors and states sooner rather than later to develop teach-out plans that serve the best interests of students.

False Certification Discharge

The proposed regulations in the NPRM update the Department's regulations regarding false certification loan discharges in response to the change made to the HEA by the Consolidated Appropriations Act, 2012. That action by Congress eliminated the option for students who did not have a high school diploma or its equivalent to receive Title IV aid by demonstrating an ability to benefit and to codify current practices. Whereas the ability to benefit test once allowed students who were unable to obtain an official high school transcript or diploma to qualify for Title IV aid by other mechanisms, the elimination of this test prevents them from receiving Title IV aid. Under the proposed regulations, when a student is unable to obtain an official high school transcript, but attests in writing under penalty of perjury that he or she has completed a high school degree, the student may receive Title IV financial aid, but will not then be eligible for a false certification discharge if the student had misstated the truth in signing the attestation. This provision of the proposed regulations simply updates the regulations to codify current practice.

The Department does not believe that there are significant numbers of students who are unable to obtain an official transcript or diploma, but institutions that serve adults who may have completed high school decades earlier, coupled with recent experiences related to working with institutions following natural disasters, demonstrates the importance of this alternative.

Financial Responsibility

The NPRM would establish mandatory and discretionary triggering events that could have a material adverse impact on an institution's financial condition that warrant financial protection.

The mandatory triggering events are:

- Liabilities arising from defense to repayment discharges adjudicated by the Secretary;
- Liabilities from a final judgment or determination arising from an administrative action or judicial proceeding;
- Withdrawal of owner's equity, except for withdrawal is made to satisfy tax liabilities;
- The SEC issues an order suspending trading or revoking the registration of the institution's securities or suspends trading on a national securities exchange;
- The national exchange on which the institution's securities are traded notifies the institution that it is not in compliance with listing requirements and as a result its securities are delisted either voluntarily or involuntarily; and

Under the provisions of the NPRM, the Department would require financial protection if the amount of the liability or withdrawal of owner's equity causes the institution's composite score to fall below 1.0. For the SEC and exchange actions, financial protection would be required when the Department is informed those actions.

The discretionary triggering events are:

- An institutional accreditor issues a show-cause order that would result in the withdrawal, revocation, or suspension of the institution's accreditation;
- The institution violated a provision of a security or loan agreement and under the terms of that agreement a default or delinquency occurs that enables or requires the creditor to impose restrictions, sanctions, or penalties in response to that violation;
- The institution violated a State licensing or authorizing requirement and is notified that its licensure or authorization will be withdrawn or terminated if it does not take steps to come into compliance with that requirement;
- A proprietary institution did not derive at least 10 percent of its revenue from non-title IV funds for one year; and
- The institution's two most recent cohort default rates are 30 percent or more--unless the institution files a challenge, request for adjustment, or appeal and that action or request remains pending or results in reducing its default rate for either of those years or precludes the rates from resulting in a loss of edibility or provisional certification.

Under the NPRM, the Department would review the reasons and circumstances giving rise to these triggering events and any information provided by the institution before determining whether to require financial protection.

<u>In addition, the NPRM would:</u>

- Provide that the Secretary may accept other types of surety or financial protection in addition to letters of credit and that a hearing official must uphold the amount of financial protection required by the Secretary unless certain conditions are met;
- Expand the types of financial protection acceptable to the Secretary;
- Provide that a limitation on an institution's participation in the Title IV programs may include changing the institution's status from fully certified to provisionally certified; and
- Establish the actions or events that have or may have an adverse material effect on an institution's financial condition and Revise Appendices A and B of the financial responsibility regulations to conform with changes in accounting standards.

Composite Score Alignment with New Accounting Standards

The Federal Accounting Standards Board (FASB) has updated accounting standards with regard to the treatment of long-term lease liabilities in audited financial statements. Under the new FASB standards, an institution that has long-term real estate or property, plant, and equipment leases would need to include the full liability associated with that lease, as opposed to the annual cost of that least, in their audited financial statements. This is a significant change in FASB standards and one that could have a dramatic impact on an institution's composite score, even if the financial condition of the institution has not changed. Therefore, the Department will consider engaging in negotiated rulemaking to update the Composite Score to take into account this and other changes in FASB standards. The proposed regulations provides a six year period of time during which an alternative composite score can be calculated and used to evaluate an institution's financial responsibility ratio, providing time for the Department to update the Composite Score calculation. The Department does not wish to encourage institutions to take shorter term leases simply to pass the Composite Score since shorter term leases could increase the cost of education, create instability for students and likely increase the number and frequency of closed schools.

Other Provisions

The proposed regulations would also:

- Prohibit guaranty agencies and FFEL Program lenders from capitalizing the outstanding interest on a FFEL loan when the borrower rehabilitates a defaulted FFEL loan;
- Prohibit guaranty agencies from charging collections costs when a borrower enters into a repayment agreement within 60 days of the notice of default;
- Specify that a loan discharge based on school closure, false certification, an unpaid refund, or a defense to repayment will lead to the elimination of or recalculation of the subsidized usage period that is associated with the loan or loans discharged;
- Require institutions to accept responsibility for the repayment of amounts discharged by the Secretary pursuant to the borrower defense to repayment, closed school discharge, false certification discharge, and unpaid refund discharge regulations;
- Require the repayment of funds and the purchase of loans by the school if the Secretary determines that the school is liable as a result of a successful claim for which the Secretary discharged a loan, in whole or in part; and
- Rescind specified provisions of the 2016 final regulations that have not yet become effective.

Public Comment Period

The 30-day public comment period for these proposed regulations will begin once they are published in the Federal Register.