

# **SUMMARY OF THE 2019 FINAL INSTITUTIONAL ACCOUNTABILITY REGULATIONS**

## **Borrower Defense to Repayment**

The Department of Education establishes new Final Regulations to adjudicate borrower defense to repayment claims on Direct Loans and Direct Consolidation Loans first disbursed on or after July 1, 2020. The Final Regulations create clear, consistent, and transparent notice and procedures for borrowers and for schools. Borrowers will receive the protection they deserve under these regulations and will be assured fair treatment. These regulations recognize the importance of every borrower and their unique circumstances and experiences.

The Final Regulations provide a legally grounded, reasoned, and appropriate definition of “misrepresentation” and enable borrowers and institutions to provide evidence to support their claims, receive information about evidence in the Secretary’s possession, and respond to evidence provided by the other party. Borrowers will have three years subsequent to leaving their institution to file a claim. This time period provides ample time for borrowers to make a defense to repayment claim and aligns with the Department’s records retention policies.

The Final Regulations permit institutions to choose their own internal dispute resolution processes, provided that they clearly disclose those processes to their students. The Department has also revised its regulations regarding closed-school discharge provisions, including the expansion of the “look-back” period, and false certification discharges. Finally, the Final Regulations include strong financial responsibility provisions in order to establish the appropriate and effective conditions or events that have, or are likely to have, an adverse material effect on an institution’s financial condition and which warrant financial protection for the Department. These regulations also update the definitions of terms used to calculate an institution’s composite score to conform with changes in the Financial Accounting Standards Board (FASB) accounting standards, as well as address leases and long-term debt.

## **Regulatory Background**

The Department first promulgated the Direct Loan Program’s Borrower Defense to Repayment regulation in 1994. Though the regulation had 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 that it would consider borrower defense claims prior to default or collection proceedings. Since 2015, the Department has received tens of thousands of claims. The Department last published final Borrower Defense to Repayment regulations on November 1, 2016.

After negotiated rulemaking, publishing a Notice of Proposed Rulemaking, and receiving over 30,000 comments on the NPRM, the Department is publishing these new final regulations that will become effective on July 1, 2020. Some entities may choose to implement certain provisions prior to July 1, 2020.

The Final Regulations preserve three borrower defense periods:

- 1) Loans first disbursed prior to July 1, 2017, which are subject to pre-2016 regulations;
- 2) Loans first disbursed on or after July 1, 2017 and before July 1, 2020, which are subject to final regulations published on November 1, 2016, and
- 3) Loans first disbursed on or after July 1, 2020, which are subject to the 2019 regulations.

The Final Regulations will:

- Provide borrowers the right to assert defense to repayment claims against institutions for loans first disbursed on or after July 1, 2020, without regard to whether the loan is in default or in collection proceedings.
- Maintain the current rule's preponderance of the evidence standard for all borrower defense-to-repayment claims.
- Allow borrowers ample opportunity to file defense to repayment claims.
- Create streamlined and fair procedures that ensure basic due process for both borrower and institutions.
- Give students the ability to allege a specific amount of financial harm.
- Enables the Secretary to determine at the time she provides borrower defense to repayment relief that there is sufficient evidence to require reimbursement from the school.
- Extend the closed school discharge window from 120 days to 180 days.
- Encourage institutions to close only after the completion of well-planned teach-outs that provide students with the reasonable opportunity to finish their programs.
- Allow students to choose between accepting an institution's offer of a teach-out opportunity or submitting a closed school discharge application to the Department.
- Provide a financial responsibility framework with fair, clear, and verifiable requirements for recalculating an institution's financial responsibility composite score and triggering additional security to protect taxpayers.
- Update composite score calculations to reflect recent changes to accounting standards.

### **Public Comment**

The Department received tens of thousands of public comments that helped inform and further refine the Final Regulations. As a result of public comments, the Department made the following significant changes from the NPRM:

- Allows defense to repayment claims even if a student is not in default or in collection proceedings.
- Maintains a preponderance of the evidence standard for all claims, as was the case in, and prior to, the 2016 rule.
- Aligns the limitation period for all borrower defense to repayment claims to three years from the borrower's date of departure from the institution, whether due to withdrawal or graduation.
- The Secretary also may extend the limitations period or reopen a borrower defense to repayment application due to a final judgment by a court or a final decision by an arbitrator that establishes that an institution made a misrepresentation, as defined in the Final Regulations.
- Clarifies that the definition of misrepresentation must directly and clearly relate to 1) enrollment or continuing enrollment at the institution school or 2) the provision of educational services for which the loan was made. The Final Regulations set forth specific examples that may serve as evidence of misrepresentation.
- Requires the borrower to allege the financial harm incurred due to the misrepresentation and clarifies that the amount of relief may exceed the amount of financial harm alleged by the borrower but may not exceed the borrower's full federal student loan liability.

- Ensures a student at a closing school offering a teach-out plan to choose either a closed school discharge or a teach-out and clarifies the exceptional circumstances under which the Secretary may extend the closed-school discharge look-back period beyond 180 days.
- Maintains the removal of financial responsibility triggers that do not allow for due process but restores the discretionary trigger for high dropout rates and creates a new mandatory trigger for two or more unresolved discretionary triggers.
- Grandfathers existing leases and long-term debt, applies new FASB requirements to new leases, and requires tie-in to plant, property, and equipment (PP&E) only for new long-term debt.

## **Summary of Major Provisions:**

### **Federal Standard**

The Final Regulations put in place a borrower defense process that is clear, understandable, and easily accessible for borrowers, facilitating the collection and review of evidence for deciding claims upon a single standard and ensuring claims are processed efficiently, carefully, transparently, and fairly. This new Federal standard provides as follows: the 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; the misrepresentation directly and clearly related to the borrower's enrollment or continuing enrollment at the institution or the institution's provision of education services for which the loan was made; and the borrower was financially harmed by the misrepresentation.

### **Affirmative and Defensive Claims**

In the 2018 NPRM, the Department proposed to continue accepting defensive claims, while also providing alternative approaches, including accepting both affirmative and defensive claims. After careful consideration of the public comments, the Department has decided to remove any distinction between affirmative and defensive claims; a borrower will not be required to go into default or be subject to collections to be eligible to file a claim. Only the limitations period, discussed below, governs when the borrower may file a claim. The Final Regulations also encourage students to seek remedies directly from their school when acts or omission by the school, including those that cannot support a borrower defense to repayment claim.

### **Evidence Standard**

The 2016 final regulations provided for a preponderance of the evidence standard for all borrower defense claims. In the 2018 NPRM, the Department proposed alternative approaches to the evidence standard that could be used in the Department's adjudication of borrower defense claims. As a result of the Department's careful consideration and analysis of public comments, the Department maintains a preponderance of the evidence standard for all borrower defense to repayment claims.

### **Notice and Process Requirements for Institutions and Students**

The Final Regulations make substantial changes to the notice and process provisions of the 2016 final regulations. To file a claim with the Department, the borrower signs and submits, under penalty of perjury, a completed application and a waiver permitting the institution that the borrower attended to provide the Department information from the borrower's records relevant to the defense to repayment claim. Together with their application, the borrower must provide evidence of his or her allegations with the application and state whether he or she has made related claims with any third party. The borrower also must state the amount of financial harm suffered. The Secretary automatically grants

forbearance on the loan for which a borrower defense to repayment has been asserted, if the borrower is not in default on the loan, unless the borrower declines such forbearance.

The Department then notifies the institution of the claim, provides the institution the borrower's application, and allows the institution to respond. The evidence provided by the institution will be shared with the borrower, who will then be given the opportunity to reply. The Secretary has the ability to consider any other relevant evidence in the Secretary's possession, including the Department's internal records, as long as the borrower and the institution have the opportunity to respond to the evidence.

After consideration of the application and all the relevant evidence, the Department will provide a written decision to the parties that includes the reasons for the determination. Written decisions are final; neither students nor institutions may appeal.

### **Limitations Period**

In the 2018 NPRM, the Department proposed: 1) to allow defensive claims at any time when asserting a claim during a collections proceeding, which could occur at any time during the repayment period; and 2) if affirmative claims were to be adopted, that the limitations period would be three years. After careful consideration of the public comments, the Department has decided that the limitations period for all claims will be three years from the date that the borrower leaves the school for any reason, whether withdrawal or graduation.

### **Definition of Misrepresentation**

In the 2018 NPRM, the Department proposed a "misrepresentation" definition, as follows: "A statement, act, or omission by an eligible institution to a borrower upon which the borrower reasonably relies that is false, misleading, deceptive, and made with knowledge of its false, misleading, or deceptive nature or with reckless disregard for the truth and directly and clearly related to the making of a Direct Loan, or a loan repaid by a Direct Consolidation Loan, for the enrollment at the school or to the provision of educational services for which the loan was made."

In the Final Regulation, the Department defines a "misrepresentation" as: a statement, act, or omission by an eligible school to a borrower that is (a) false, misleading, or deceptive, (b) that was made with knowledge of its false, misleading, or deceptive nature or with a reckless disregard for the truth, and (c) that directly and clearly relates to either 1) enrollment or continuing enrollment at the institution; or 2) the provision of educational services for which the loan was made.

Evidence that a misrepresentation may have occurred includes, but is not limited to: actual licensure passage rates that are different from those in marketing materials, website, and communications; actual employment rates materially different from those in the institution's marketing materials, website, and communications; institutional selectivity or rankings, student admission profiles, or institutional rankings that are materially different from those in marketing materials, websites, and communications; the institution does not possess certifications, accreditation, or approvals for programs that it represents that it possesses; representations regarding the educational resources provided; representations regarding the transferability of credits that, in fact, do not transfer to other institutions; representations regarding the employability or specific earnings of graduates without evidence; representations regarding the availability, amount, or nature of financial assistance provided; representations regarding the amount, method, or timing of payment of tuition and fees that is materially different from the

amount, method, or timing of actual tuition and fees; representations regarding whether an institution's courses or programs are endorsed by employment agencies, industry members, government officials, former students, US armed forces, or others without permission; and representations regarding the prerequisites for enrollment in a course or program.

### **Financial Harm**

In the 2018 NPRM, the Department proposed that there would be no presumption of full borrower defense claim relief and that the amount of relief to which the borrower is entitled would be reduced by any amounts that the borrower obtained from the school or other sources. The Department also invited comment on a potential relief methodology.

In the Final Regulations, the Department continues the presumption against full relief. Financial harm, as determined by the Department, is the amount of monetary loss that a borrower incurs as a consequence of a misrepresentation. Financial harm does not include damages for nonmonetary loss. The Final Regulations do not consider the act of taking out a Direct Loan, alone, as evidence of financial harm. Financial harm also cannot be predominantly due to intervening local, regional, or national economic or labor market conditions, nor can it arise from the borrower's voluntary decision to pursue less than full-time work or not to work or result from a voluntary change in occupation. Evidence of financial harm may include, but is not limited to, the following circumstances: periods of unemployment upon graduation unrelated to national or local economic recessions; a significant difference between the amount of tuition and fees that the institution represented and the actual amount of tuition and fees; the borrower's inability to secure employment in the field of study for which they were guaranteed employment by the institution; and the borrower's inability to complete the program due to the institution no longer offering a requirement necessary for completion of the program.

The Secretary will determine financial harm based upon individual earnings and circumstances; the Secretary may also consider evidence of program-level median or mean earnings in determining the amount of relief to which the borrower may be entitled, in addition to the evidence provided by the individual about that individual's earnings and circumstances, if appropriate. The Department must have some information relating to the borrower's career experience subsequent to enrollment at the institution. The goal is a proper resolution for each borrower defense claim, which requires evidence not only of an institution's alleged misrepresentations, but also of the borrower's reliance on that information in making an enrollment decision and monetary loss to the borrower as a result of the institution's misrepresentation.

### **Pre-Dispute Arbitration Agreements and Class Action Waivers**

The 2016 final regulations prohibited institutions from using pre-dispute arbitration agreements and class action waivers. The 2018 NPRM allowed for the use of the agreements and waivers, so long as the institutions provided plain-language disclosures to students when used. The 2019 Final Regulations permit the use of the agreements and waivers as a condition of enrollment, so long as the institutions provide plain-language disclosures to students and place that disclosure on their website where information regarding admissions, tuition, and fees is presented. Institutions that use pre-dispute arbitration agreements and class action waivers are required to include information in the borrower's entrance counseling regarding the school's internal dispute and arbitration processes.

### **Closed-School Discharge**

The Final Regulations 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.

The Final Regulations allow for the borrower to choose whether to apply for a closed school loan discharge or accept a teach-out opportunity. In addition, the closed school discharge window is expanded from 120 days to 180 days prior to the school's closure. The Final Regulations clarify the exceptional circumstances for extending this window, including: 1) revocation or withdrawal by an accrediting agency of the school's institutional accreditation; 2) revocation or withdrawal by the State authorization or licensing authority of the school's authorization or license to operate or to award academic credentials in the State; 3) termination by the Department of the school's participation in a program under Title IV, of the Higher Education Act (HEA), as amended; or 4) the teach-out of the student's educational program exceeds the 180-day window for a closed school loan discharge.

The Final Regulations do not allow for an automatic closed school discharge process and, instead, require that a borrower, who is applying for a closed-school loan discharge, must submit an application.

### **False Certification Discharge**

Under these Final Regulations, to apply for a false certification discharge, the borrower must submit an application. If the school had previously certified the borrower eligibility for Title IV funds, but the borrower was, in fact, not a high school graduate, the borrower would qualify for false certification discharge. If the borrower submitted a written attestation to the school stating that they were a high school graduate, but in fact the borrower was not, the borrower does not qualify for a false certification loan discharge. When determining whether the borrower is eligible for a false certification discharge, the Department will notify the borrower in writing and identify the reasons for the determination.

### **Financial Responsibility – Mandatory and Discretionary Triggering Events**

The Final Regulations establish mandatory and discretionary triggering events that have, or could have, a materially adverse impact on an institution's financial condition that warrant financial protection. The mandatory triggering events are:

- 1) Liabilities arising from a settlement, final judgment from a court, or final determination arising from an administrative action or proceeding initiated by a Federal or State entity;
- 2) Withdrawal of owner's equity from the institution, unless the withdrawal is a transfer to an entity included in the affiliated entity group upon whose basis the institution's composite score was calculated;
- 3) For publicly traded institutions, the Securities and Exchange Commission issues an order suspending or revoking the registration of the institution's securities or suspends trading of the institution's securities on any national securities exchange, the national securities exchange notifies the institution that it is not in compliance with the exchange's listing requirements and the institution's securities are delisted, or the SEC is not in timely receipt of a required report and did not issue an extension to file the report; and
- 4) For the fiscal year reported, when an institution is subject to two or more discretionary triggering events, those events become mandatory triggering events, unless a triggering event is resolved before any subsequent event(s) occurs.

Discretionary triggering events in the Final Regulations include:

- 1) The institution's accrediting agency issues an order, such as a show-cause order or similar action, that if not satisfied could result in the loss of institutional accreditation;
- 2) The institution violated a provision or requirement in a security or loan agreement with a creditor;
- 3) The institution's State licensing or authorizing agency notified the institution that it has violated a State licensing or authorizing agency requirement and that the agency intends to withdraw or terminate the institution's licensure or authorization, if the institution does not take the steps necessary to come into compliance;
- 4) The institution's failure to meet the 90/10 requirement;
- 5) As calculated by the Secretary, the institution has high annual dropout rates; and
- 6) The institution's two most recent official cohort default rates are thirty percent or greater, unless the institution files a challenge, which results in reducing below thirty percent the official cohort default rate for either of or both of those years or precludes the rates from either or both years from resulting in a loss of eligibility or provisional certification.

### **Financial Responsibility - Financial Protection and Other Related Issues**

The Final Regulations provide that the Secretary may accept other types of surety or financial protection, in addition to letters of credit. A hearing official must uphold the amount of financial protection required by the Secretary unless certain conditions are met.

The Final Regulations update the definitions of terms used to calculate the composite score and otherwise amend the composite score methodology to reflect changes in FASB accounting standards. The Final Regulations will grandfather existing leases and apply the FASB requirements only to new leases. The Final Regulations also grandfather existing long-term debt and requires tie-ins to plant, property, and equipment only for new long-term debt. In addition, the Final Regulations revise Appendices A and B of the financial responsibility regulations to conform with the updates and changes in accounting standards.

The Final Regulations 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. Guaranty agencies are prohibited from charging collections costs when a borrower enters into a repayment agreement within 60 days of the notice of default. The Final Regulations 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. Institutions are required 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. The Final Regulations also now 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. Finally, the Final Regulations rescind specified financial responsibility provisions of the 2016 final regulations that have not yet become effective.