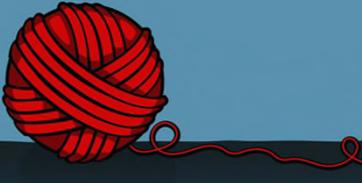




**Proposed Changes to the Financial
Responsibility Standards**
 Part of the *Unraveling the Proposed Borrower Defense Rule*
 Webinar Series | Aug.-Sept. 2016






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.





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.



WEBINAR SERIES SCHEDULE

- The Proposed Borrower Defense Framework (August 24, 2016)
- **Proposed Changes to the Financial Responsibility Standards (August 31, 2016)**
- The Proposed Elimination of Arbitration Clauses (September 7, 2016)
- The Proposed Repayment Rate for Proprietary Schools (September 14, 2016)

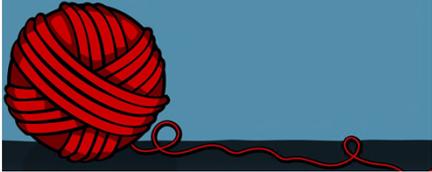


PRESENTATION OUTLINE

- The Current Rulemaking
- Fin. Resp. Fundamentals
- The Proposed Fin. Resp. Framework
- Select Actions & Triggering Events
- Process and Consequences
- TC Resources



THE CURRENT RULEMAKING




THE RULEMAKING TIMELINE

DATE	2016 RULEMAKING EVENTS
Jan. – Mar.	• Negotiated rulemaking committee meets
June 16	• Proposed rules published
August 1	• Comment period closes
Nov. 1	• Deadline for publication of final rule*
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.



ELEMENTS OF THE PROPOSED RULE

Borrower Defense Framework

**Financial
Responsibility Triggers**

**Arbitration
Agreements**

**Closed School
Discharge**

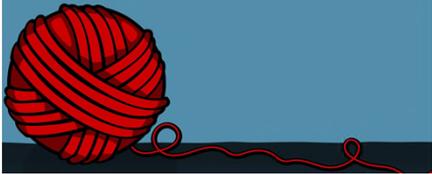
**False
Certification
Discharge**

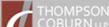
**Misrep-
resentation**

**Repayment
Rates for
Prop. Schools**



FINANCIAL RESPONSIBILITY FUNDAMENTALS





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.



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	<ul style="list-style-type: none"> Financial ratios must yield composite score of at least 1.5 (668.172)
Sufficient Cash Reserves	<ul style="list-style-type: none"> Must have sufficient cash reserves to make required returns of unearned aid (668.173)
Current in Debt Payments	<ul style="list-style-type: none"> May fail in violation of existing loan agreements or delinquent in debt obligations (668.171(b)(3))
Meeting Financial Obligations	<ul style="list-style-type: none"> Making all required refunds and payments of debts and liabilities to ED (668.171(b)(4))
Clean Audit	<ul style="list-style-type: none"> No qualified opinion or doubt about continued existence of institution (668.171(d)(1))
Past Performance	<ul style="list-style-type: none"> No violation of past performance provisions at 668.174.



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 PROPOSED FINANCIAL RESPONSIBILITY FRAMEWORK





THE PROPOSED FR FRAMEWORK

ED proposes to revise the general standards of financial responsibility for private, non-profit and proprietary institutions located at 668.171, and include a new set of **actions and triggering events**.

Proposed 34 CFR § 668.171



THE PROPOSED FR FRAMEWORK

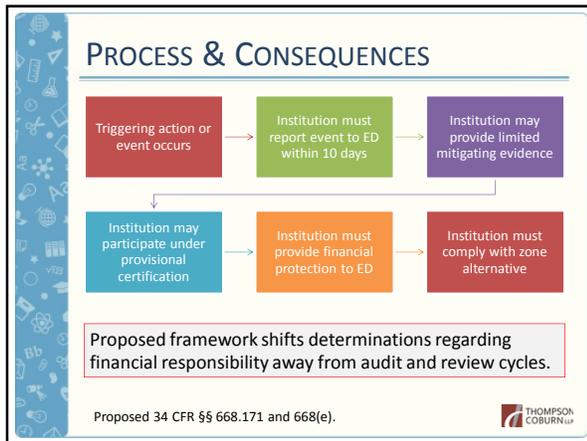
Passing Composite Score	<ul style="list-style-type: none"> Financial ratios must yield composite score of at least 1.5 (668.172)
Sufficient Cash Reserves	<ul style="list-style-type: none"> Must have sufficient cash reserves to make required returns of unearned aid (668.173)
Past Performance	<ul style="list-style-type: none"> No violation of past performance provisions at 668.174.
Clean Audit	<ul style="list-style-type: none"> No qualified opinion or doubt about continued existence of institution (668.171(d)(1))
Meeting Financial Obligations and Providing Administrative Resources	<ul style="list-style-type: none"> Must meet financial obligations and provide administrative resources necessary to comply with financial aid requirements. An institution automatically fails to satisfy this standard if it is subject to one or more of the 10 proposed actions or triggering events.



ACTIONS AND TRIGGERING EVENTS

Lawsuits and other actions	Repayment of borrower defense liabilities	Accrediting agency actions
Fail to satisfy loan agreements and obligations	Fail 90/10 Revenue Test	Triggers for publicly-traded institutions
Failing gainful employment programs	Withdrawal of owner's equity	High Cohort Default Rates
Other events or conditions		





POINTS OF SIGNIFICANT CONCERN

Included among triggers are many events that represent only the **possibility** of financial stress, increasing likelihood of a “false-positive” – a healthy institution experiencing a triggering event.

- This means **materiality** and **process** controls are **critical**.
- It also calls into question whether proposed framework is in harmony with HEA.

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LAWSUITS AND OTHER ACTIONS

Debts, liabilities, and settlements from regulatory actions based on education claims:

Currently or at any time during the three most recently completed award years, the institution is or was required to pay a debt or incurs a liability arising from an **audit, investigation, or similar action** initiated by a State, Federal, or other **oversight entity**, or **settles or resolves a suit** brought against it by that entity, that is based on claims related to the making of a Federal loan or the provision of educational services, for an amount that, for one or more of those years, exceeds the **lesser** of [\$750,000] or 10 percent of the institution's current assets.

Proposed 34 CFR § 668.171(c)(1). 

LAWSUITS AND OTHER ACTIONS

Initiation of regulatory suits based on education claims:

Currently **being sued** by a State, Federal, or other oversight entity based on claims related to **the making of a Federal loan or the provision of educational services** for an amount that exceeds the **lesser** of [\$750,000] or 10 percent of the institution's current assets.

Proposed 34 CFR § 668.171(c)(1). 

LAWSUITS AND OTHER ACTIONS

Initiation of regulatory suits based on claims of any kind:

Currently **being sued** by one or more State, Federal, or other oversight entities based on **claims of any kind** (except claims related to the making of a Federal loan or the provision of educational services), and the potential monetary sanctions or damages from that suit **or suits** are in an amount that exceeds 10 percent of the institution's current assets.

Proposed 34 CFR § 668.171(c)(1). 

LAWSUITS AND OTHER ACTIONS

Initiation of suits by private parties based on education claims:

The institution is currently **being sued** in a lawsuit filed under the False Claims Act, 31 U.S.C. 3729 et seq., or by one or more **private parties** for claims that relate to the making of loans to students for the purpose of enrollment or the institution's provision of educational services, if that suit (A) has **survived a motion for summary judgment** by the institution and has not been dismissed; and (B) seeks relief in an amount that exceeds 10 percent of the institution's current assets.

Proposed 34 CFR § 668.171(c)(1). 

LAWSUITS AND OTHER ACTIONS

Debts, liabilities, and settlements exceeding the 10 percent threshold:

During a fiscal year for which the institution has not submitted its audited financial statements to the Secretary, the institution entered into a settlement, had judgment entered against it, incurred a liability, or **otherwise resolved** either a **regulatory** suit or a **private party** suit based on education claims for an amount that exceeds **10 percent** of the institution's current assets.

Proposed 34 CFR § 668.171(c)(1). 

POINTS OF SIGNIFICANT CONCERN

- The mere filing of a lawsuit would be a trigger.
- Qualifying suits could be brought by virtually any person or entity, to include "State, Federal, or other oversight entities" or "private parties."
- Any individual can state a claim and seek relief in any amount, without regard to how outrageous and unrealistic it may be.



POINTS OF SIGNIFICANT CONCERN

- When suing an institution of higher education, it is easy to state a claim that relates to the institution’s “provision of educational services.”
- There is no process by which to evaluate **materiality** on a case-by-case basis.



POINTS OF SIGNIFICANT CONCERN

- The \$750,000 threshold may not be material to the financial health of large institutions.

Large institutions would be discouraged from settling or resolving claims. A large institution might prefer to risk a two million dollar judgment over a one million dollar settlement that would trigger a multi-million dollar letter of credit.



POINTS OF SIGNIFICANT CONCERN

- In the case of claims filed by private parties, the claim would have to be one that has “survived a motion for summary judgment by the institution and has not been dismissed.”

Summary judgment can only be granted when there is no genuine issue of material fact. Plaintiffs can easily create disputed facts and thereby avoid summary judgment simply by filing an affidavit repeating their allegations.



POINTS OF SIGNIFICANT CONCERN

- Further, by inserting summary judgement requirement, ED is incentivizing institutions to forgo a motion for summary judgment and to proceed directly to trial.
- This is contrary to the purpose of summary judgment, which is to weed out meritless claims prior to trial and thereby ease the burden on courts.

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ACCREDITING AGENCY ACTIONS

Required to submit a teach-out plan:

Currently or any time during the three most recently completed award years, the institution is or was required by its accrediting agency to **submit a teach-out plan**, for a reason described in 602.24(c)(1), that covers the institution or any of its branches or additional locations.

Proposed 34 CFR § 668.171(c)(3).

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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.

Proposed 34 CFR § 602.24(c)(1).

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ACCREDITING AGENCY ACTIONS

Subject to accretitor action:

Currently or any time during the three most recently completed award years, 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 to its accreditation... and the accrediting agency does not notify ED within six months that it has withdrawn that action because the institution has come into compliance.

Proposed 34 CFR § 668.171(c)(3).



POINTS OF SIGNIFICANT CONCERN

- The decision to teach-out a location may bear no relationship to an institution's financial health; it may simply reflect market changes.

Institutions would be discouraged from closing locations that should be retired, in some cases to improve the financial health of the institution.



POINTS OF SIGNIFICANT CONCERN

- A State decision to revoke a program license or authorization may bear no relationship to the financial health of the institution, and could even be prompted by the institution's request.
- Show cause has not previously been considered a basis for significant concern.

Accreditors may cease using show cause in the manner it has been used historically.



OTHER EVENTS OR CONDITIONS

Generally includes **any event** or condition that, in ED's view, 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 to...

- A significant fluctuation in the amount of Direct Loan or Pell Grant funds received.

Proposed 34 CFR § 668.171(c)(10). 

OTHER EVENTS OR CONDITIONS

- Citation by a State licensing or authorizing agency for failing State or agency requirements.
- Failing a "financial stress test" developed by ED to determine whether an institution has capital necessary to meet its financial obligations.

Proposed 34 CFR § 668.171(c)(10). 

OTHER EVENTS OR CONDITIONS

- The institution or its corporate parent has a non-investment grade bond or credit rating.
- High annual dropout rates, as calculated by ED.
- Any adverse event reported to the SEC on a Form 8-K.

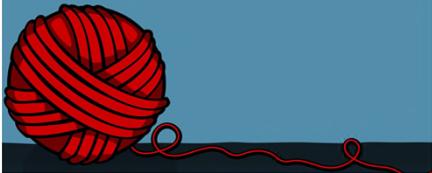
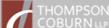
Proposed 34 CFR § 668.171(c)(10). 

POINTS OF SIGNIFICANT CONCERN

- ED does not define the term “material adverse effect” or discuss it in the commentary.
- The proposed rule creates an unworkable reporting requirement when read in the context of the rest of the regulation.
- The six examples of events are vague and it is unclear how they relate to an institution’s financial health.



PROCESS AND CONSEQUENCES

PROCESS AND CONSEQUENCES



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graph LR
    A[Triggering action or event occurs] --> B[Institution must report event to ED within 10 days]
    B --> C[Institution may provide limited mitigating evidence]
    C --> D[Institution may participate under provisional certification]
    D --> E[Institution must provide financial protection to ED]
    E --> F[Institution must comply with zone alternative]
  
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Proposed 34 CFR §§ 668.171 and 668(e).



PROCESS AND CONSEQUENCES

If a triggering event occurs, an institution is **automatically** deemed unable to meet its financial or administrative obligations.

There is no opportunity for institutions to provide evidence or documentation relating to the merit or materiality of the triggering event, or to otherwise be “heard.”

Proposed 34 CFR § 668.171(d). 

PROCESS AND CONSEQUENCES

Proposed rule only permits institutions to demonstrate:

- Disclosure of judicial or administrative proceeding for public company not a material event.
- Withdrawal of owner’s equity met certain requirements.
- Violation of loan agreement waived by the creditor.

Even in these three cases, ED is not required to accept or review evidence provided by the institution or to explain the basis of its determination that a triggering event is indeed material.

Proposed 34 CFR § 668.171(d). 

PROCESS AND CONSEQUENCES

Financial penalties for triggering events would be **stacked**.

[E]ach of these triggering events would require a form of financial protection, such as a letter of credit, of at least 10 percent, so an institution with three triggering events would have to submit financial protection for at least 30 percent of its prior year title IV, HEA program funds.

81 Fed. Reg. 39368 (June 16, 2016). 

PROCESS AND CONSEQUENCES

If an institution is required to provide “financial protection” to ED, it must:

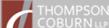
- **Disclose** to enrolled and prospective students.
- **Post** disclosure on home page of website.

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

Proposed 34 CFR § 668.41(h)(10).



TC RESOURCES



RESOURCES FROM TC

- Borrower defense webinar series on demand.
- [REGucation](#) higher education law and policy blog.



CONTACT INFORMATION

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50