DEPARTMENT OF EDUCATION

34 CFR Parts 668, 674, 682, and 685

RIN 1840–AD26

[Docket ID ED–2018–OPE–0027]

Student Assistance General Provisions, Federal Perkins Loan Program, Federal Family Education Loan Program, and William D. Ford Federal Direct Loan Program

AGENCY: Office of Postsecondary Education, Department of Education.

ACTION: Notice of proposed rulemaking.

SUMMARY: The Secretary proposes to create Institutional Accountability regulations that would amend the regulations governing the William D. Ford Federal Direct Loan (Direct Loan) Program to establish a Federal standard for evaluating and a process for adjudicating borrower defenses to repayment for loans first disbursed on or after July 1, 2019, and provide for actions the Secretary may take to collect from schools financial losses due to successful borrower defense to repayment discharges. The Secretary also proposes to withdraw (*i.e.* rescind) certain amendments to the regulations already published but not yet effective.

DATES: We must receive your comments on or before August 30, 2018.

ADDRESSES: Submit your comments through the Federal eRulemaking Portal or via postal mail, commercial delivery, or hand delivery. We will not accept comments submitted by fax or by email or those submitted after the comment period. To ensure that we do not receive duplicate copies, please submit your comments only once. In addition, please include the Docket ID at the top of your comments.

If you are submitting comments electronically, we strongly encourage you to submit any comments or attachments in Microsoft Word format. If you must submit a comment in Adobe Portable Document Format (PDF), we strongly encourage you to convert the PDF to print-to-PDF format or to use some other commonly used searchable text format. *Please do not submit the PDF in a scanned format.* Using a print-to-PDF format allows the Department to electronically search and copy certain portions of your submissions.

- *Federal eRulemaking Portal:* Go to *www.regulations.gov* to submit your comments electronically. Information on using *Regulations.gov*, including instructions for accessing agency documents, submitting comments, and viewing the docket, is available on the site under ''Help.''
- *Postal Mail, Commercial Delivery, or Hand Delivery:* The Department strongly encourages commenters to submit their comments electronically. However, if you mail or deliver your comments about the proposed regulations, address them to Jean-Didier Gaina, U.S. Department of Education, 400 Maryland Ave. SW, Mail Stop 294–20, Washington, DC 20202.

Privacy Note: The Department's policy is to make comments received from members of the public available for public viewing on the Federal eRulemaking Portal at *www.regulations.gov.* Therefore, commenters should be careful to include in their comments only information that they wish to make publicly available.

FOR FURTHER INFORMATION CONTACT: For further information related to Borrower Defenses to Repayment, Pre-dispute Arbitration Agreements, Internal Dispute Processes, and Guaranty Agency Fees, Barbara Hoblitzell at (202) 453–7583 or by email at: *Barbara.Hoblitzell@ed.gov* or Annmarie Weisman at (202) 453–6712 or by email at: *Annmarie.Weisman@ed.gov.* For information related to False Certification Loan Discharge, and Closed School Loan Discharge, Brian Smith at (202) 453–7440 or by email at: *Brian.Smith@ed.gov.* For information regarding Financial Responsibility and Institutional Accountability, John Kolotos at (202) 453–7646 or by email at: *John.Kolotos@ed.gov.* For information regarding Recalculation of Subsidized Usage Periods and Interest Accrual, Ian Foss at (202) 377–3681 or by email at: *Ian.Foss@ed.gov.*

If you use a telecommunications device for the deaf (TDD) or a text telephone (TTY), call the Federal Relay Service (FRS), toll free, at (800) 877–8339.

SUPPLEMENTARY INFORMATION:

Executive Summary

Purpose of This Regulatory Action:

Section 455(h) of the Higher Education Act of 1965, as amended (HEA), authorizes the Secretary to specify in regulation which acts or omissions of an institution of higher education a borrower may assert as a defense to repayment of a Direct Loan. Current regulations in 34 CFR 685.206(c) governing defenses to repayment have been in effect since 1995 but, until recently, were rarely used. Those regulations specify that a borrower may assert as a defense to repayment ''any act or omission of the school attended by the student that would give rise to a cause of action against the school under applicable State law.''

On November 1, 2016, the Department published final regulations (81 FR 75926) (the 2016 final regulations) on the topic of borrower defenses to repayment. The 2016 final regulations were developed following negotiated rulemaking and after receiving and considering public comments on a notice of proposed rulemaking. Certain provisions of the 2016 final regulations have been delayed until July 1, 2019 (83 FR 6458).

These proposed regulations are designed to:

- Provide students with a balanced, meaningful process that relies on a single, Federal standard rather than 50 State standards to ensure that borrower defense to repayment discharges are handled swiftly, carefully, and fairly;
- Encourage students to seek remedies from institutions that have committed acts or omissions that constitute misrepresentation and cause harm to the student;
- Ensure that institutions rather than taxpayers bear the burden of billions of dollars [1] in losses from approvals of borrower defense to repayment 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 or from closing precipitously;
- Enable the Department to properly evaluate institutional financial risk in order to protect students and taxpayers;
- Provide students with additional time to qualify for a closed school loan discharge;
- Address the concerns expressed by negotiators, as well as in a suit filed by an association against the Department, that large financial liabilities resulting from the unclear borrower defense standard in the 2016 final regulations could cripple or force the closure of colleges and universities, even as they produce positive outcomes for students and provide students with accurate and complete information relating to enrollment;
- Reduce uncertainty about the future of the Federal financial aid system itself due to the strain on the government of large numbers of borrower defense to repayment discharges; and

[1] The Department estimated that borrower defense activity under the 2016 final regulation would have an estimated $14.9 billion net budget impact for the 2017 to 2026 loan cohorts. 71 FR 76055.

• Most of all, to ensure that millions of American students and borrowers are provided with accurate information to inform their enrollment decisions and to ensure that students are not subjected to narrowed educational options as a result of unwarranted school closures.

The goal of the Department is to enable students to make informed decisions on the front end of college enrollment, rather than to grant them 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 and who must take personal accountability for the decisions they make. 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. Regardless, students 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 students are not relieved of their repayment obligations if later they regret the choices they made.

Through these proposed regulations, the Department is considering whether to reaffirm the Department's original interpretation of the statute, which persisted for 20 years and provided borrowers an opportunity to raise defenses to the repayment of Direct Loans only in response to collection actions by the Department, or to continue with the Department's 2015 interpretation, which allowed borrowers to raise defenses to repayment in affirmative claims. The Department adopted that interpretation in response to advocacy efforts on behalf of student borrowers who had attended institutions owned by Corinthian Colleges, Inc., but without negotiated rulemaking.

This new interpretation to allow affirmative claims was codified in the Department's 2016 final regulations. The 2015 reinterpretation was designed to expand loan forgiveness for borrowers who had attended Corinthian institutions, which, following a sequence of events, closed precipitously after the Department placed the institutions on HCM1 status and added a delay in title IV reimbursement that is typically not associated with HCM1. The Department's closed school loan discharge regulations provide that a student who was attending a school at the time of its closure, who did not complete his or her program of study prior to the school's closure, and who meets other criteria may receive a discharge of Federal student loans obtained for the student's enrollment at the institution. 34 CFR 674.33, 682.402, and 685.214. But the Department wished to extend loan forgiveness to borrowers who may not have qualified for this closed school loan discharge, so it created new policies for accepting affirmative claims.

The Department's experience with these affirmative claims has informed this NPRM. That experience has led the Department to realize that a clear Federal standard is required in order to adjudicate borrower defense claims in a fair and equitable manner. The Department has also heard concerns during the process about the Department's statutory authority to adjudicate these claims in an affirmative posture and about whether the process for adjudicating these claims appropriately balances the competing interests of borrowers, institutions, and taxpayers.

Among other issues enumerated throughout this document, the Department is concerned that a process that allows for borrowers to submit affirmative claims, where there are minimal consequences for submitting an unjustified claim, could potentially create improper incentives for borrowers with unsubstantiated allegations against schools to seek loan discharges. For example, a borrower may attempt to seek loan forgiveness simply because he or she is dissatisfied with the education received or with his or her ability to get a particular job, rather than as a result of a misrepresentation by the institution. This situation could easily increase the burden on the Department of identifying legitimate claims among those that do not meet the defense to repayment standard. And with nothing to lose by submitting a claim, a borrower could be tempted to submit a claim whether or not he or she has been harmed. The Department does not have sufficient information to determine the extent of this potential incentive effect. As of January 2018, it had received 138,989 claims, of which 23 percent had been processed, and only 2 percent of the processed claims were associated with schools other than Corinthian and ITT, but that targeted rather than random sample is insufficiently representative to support conclusions on the issue at this point.

In any case, an influx of affirmative claims could itself cause harm to borrowers. For example, even if the Department can accurately distinguish between genuine and frivolous claims, the time it takes to do so may prolong the time it takes to provide relief to deserving borrowers. And borrowers not entitled to relief may find themselves worse off if they receive a forbearance while the claim was being processed, because interest would accrue and increase the amount the borrower would be required to repay when the loan reenters repayment.

In addition, the Department is concerned that several features of the 2016 final regulations might have put the Department in the untenable position of forgiving billions of dollars of Federal student loans based on potentially unfounded accusations. Specifically, those regulations would allow the Department to afford relief to borrowers without providing an opportunity for institutions to adequately tell their side of the story. And they would allow the Department to afford relief to entire groups of borrowers, including those who did not apply for relief or who were potentially not harmed by the institution.

However, despite these concerns, the Department is considering the continuation of its current practice of accepting affirmative claims from borrowers not in a collections status. A policy that limits borrower defense eligibility to defensive claims may have the unintended effect of treating borrowers harmed by a misrepresentation who default on their loans better than other defrauded borrowers who stay out of default by responsibly enrolling in income-driven repayment plans and making payments on their loan.

In addition, lessons learned from the recent mortgage crisis raise concerns that limiting borrower defense eligibility to defensive claims could lead some relief-seeking borrowers to strategically default. Researchers observed similar strategic behavior by homeowners in response to a 2008 mortgage modification program offered by a large financial institution to borrowers who were at least sixty days delinquent.[2] The study found that the program's structure, which relied on the borrower's repayment status, yielded a thirteen percent increase in the probability of that financial institution's borrowers rolling over from current to delinquent status—evidence of strategic behavior by borrowers aiming to take advantage of mortgage modifications. A

[2] *http://www.nber.org/papers/w17065.pdf.*

similar behavioral response from relief-seeking borrowers choosing to enter default could result in a range of troubling unintended consequences, including damage to borrower credit scores, increased default collection costs for taxpayers, and increases to institutional cohort default rates.

The Department is trying very carefully to balance relief for borrowers who have been harmed by acts of institutional wrongdoing, with its obligation to the taxpayer to provide reliable stewardship of Federal dollars. With more than a trillion dollars in outstanding student loans, the Department must uphold its fiduciary responsibilities and exercise caution in forgiving student loans to ensure that it does not create an existential threat to a program that lacks typical credit and underwriting standards.

With so much at stake for all parties, it seems reasonable that consumer complaints should continue to be adjudicated through existing legal channels that put experienced judges or arbitrators in the position of weighing the evidence and rendering an impartial decision. Significant reputational damage could be done to an institution from an affirmative borrower defense claim long before an institution is given an opportunity to contest that claim in a recoupment proceeding. Such damage could weaken or even force institutions to close, regardless of the truth, extent, or other circumstances surrounding the unverified claims. And if the institution prevails in a recoupment proceeding, it is the taxpayer who is left responsible for the claims the Department approved in error.

These concerns have led the Department to reconsider and seek public comment on whether it should reaffirm the Department's original interpretation of the statute, which provided borrowers an opportunity to raise defenses to the repayment of Direct Loans only in response to collection actions by the Department. The Department is interested in comments about its statutory authority to consider defenses to the repayment of Direct Loans in an affirmative posture, and about the risks and benefits of doing so.

However, the Department is also considering continuing to accept affirmative claims from borrowers not in a collections action. In either case, the Department would need to implement provisions that would protect institutions and taxpayers against frivolous claims. Our initial review of pending claims suggests that some borrowers may believe that the process allows for a discharge based on a borrower's dissatisfaction with the education he or she received or the outcomes he or she realized following enrollment, even in the absence of a misrepresentation on the part of the institution. That is not the case. As stated in the Master Promissory Note the borrower signs when initiating their first loan, the borrower is expected to repay the loan even if the borrower fails to complete the program or is dissatisfied with the institution or his or her outcomes. The Department seeks comments from the public regarding what types of provisions or requirements could be used to reduce frivolous claims while still ensuring a borrower a fair and meaningful opportunity to seek relief in the event of fraud.

The Department is also proposing to change its approach to a possible group adjudication of borrower defense claims. The 2016 final regulations would enable the Department to initiate affirmative claims on behalf of entire groups of borrowers, if the Secretary determines that there are common facts and claims that apply to the group. However, in this NPRM, the Department is proposing a uniform standard based on a misrepresentation made with knowledge of its false, misleading, or deceptive nature or with a reckless disregard for the truth. As this proposed standard is dependent upon a fact-specific inquiry, the Department does not believe that the group process is appropriate to include in these proposed regulations. Further, a group discharge process could place an extraordinary burden on both the Department and the taxpayer, and the Department has reconsidered whether such a process appropriately balances the need to reduce burden on borrowers and the Department with the obligation to protect taxpayer funds. Because an institution can refuse to provide an official transcript for a borrower whose loan has been forgiven, group discharges could render some borrowers unable to verify their credentials or work in the field for which they trained and have enjoyed employment.

Moreover, the Department believes that a review of claims on an individual basis is necessary to ensure that it affords appropriate relief to borrowers who suffered harm from an alleged misrepresentation. Since publication of the 2016 final regulations, the Department has conducted further analyses of the tens of thousands of defense to repayment applications for Corinthian students that the Department has received to date. Those analyses have demonstrated that students enrolled at Corinthian who submitted defense to repayment applications may not all have been harmed to the same extent. An individual process would offer all borrowers fair and equal access to defense to repayment relief. And these proposed regulations would not eliminate the opportunity for Corinthian or other students with loans first disbursed prior to July 1, 2019, to seek debt relief under the 2015 interpretation of the regulation.

The Department proposes a new Federal standard to govern claims on loans made after July 1, 2019 based on an alleged misrepresentation. Under that standard, a borrower may assert as a defense to repayment an eligible institution's misrepresentation—that is, a statement, act, or omission by the school to the borrower that is (i) false, misleading, or deceptive, (ii) made with knowledge of its false, misleading, or deceptive nature or with a reckless disregard for the truth, and (iii) 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. To relate to the ''provision of educational services,'' a misrepresentation must relate 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.

The proposed standard for a borrower defense discharge differs from the standard selected in the 2016 final regulations, which was based on the Department's authority during enforcement actions. The 2016 final regulations adopted the misrepresentation standard at 34 CFR 668.71, and provided that defenses to repayment may additionally be based upon breaches of contract and certain types of judgments. The proposed standard would not provide for a defense to repayment based on such breaches of contract or other judgments. Instead, such breaches or judgments may be considered as evidence of a misrepresentation, to the extent they bear on an act or omission related to the educational services provided. The Department believes this approach will assist it to quickly and fairly review each and every application and provide equitable relief to borrowers who were harmed.

The Department's proposed standard also does not distinguish between the types of institutions that committed the misrepresentation. Appendix A of the 2016 final regulations, by contrast, took the position that a student who attended a selective, non-profit institution would

not receive debt relief even if the institution committed an act that would otherwise entitle the borrower a defense to repayment because, in the opinion of the Department, the education received was valuable despite the misrepresentation. We cannot adequately support assumptions about the inherent quality of any institution, including a selective non-profit institution. The Department accordingly does not propose to maintain this position.

The Department does propose to maintain the standard of evidence or proof required to make a successful claim that was included in the 2016 final regulations—a preponderance of the evidence. The Department believes that this standard will allow claims to be asserted and handled in a manner that is genuinely fair to students, taxpayers, and institutions, especially since a borrower in collections could have left the institution many years prior to making a claim, which would make it exceedingly difficult to meet a higher evidentiary standards. However, if the Department chooses to continue to accept affirmative claims, where barriers to submitting such claims are very low and there are no penalties for a borrower who submits an unjustified claim, the Department believes that a higher evidentiary standard may be appropriate. The Department seeks comments from the public about whether or not a clear and convincing evidence standard would be appropriate if the Department chooses to continue to accept affirmative claims and, if so, whether that clear and convincing standard should apply solely to affirmative claims or to both affirmative and defensive claims.

Finally, the Department proposes to limit the period of time during which the Secretary may recoup funds discharged under these regulations. Specifically, for loans disbursed on or after July 1, 2019, the Secretary would have five years from the date of the final determination on a borrower's defense to repayment application to initiate a proceeding to recover from the school the amount of the losses incurred by the Secretary on the discharged loans.

In addition to the changes to the borrower defense regulations discussed above, we seek in this NPRM to strengthen the Department's ability to protect the Federal taxpayer from the consequences of a school's precipitous closure by amending the Department's financial responsibility regulations. The proposed regulations identify actions or events that the Secretary may consider in determining whether a school is financially responsible, provide that the Secretary may accept other types of surety or financial protection in lieu of letters of credit, clarify that the Department may impose a limitation on a school by changing a school's participation status from ''fully certified'' to ''provisionally certified'', and update the Department's regulations as to initial and final decisions that may be made by a hearing official in a fine, limitation, suspension, or termination proceeding to incorporate the proposed alternate means of financial protection to the Department. These proposed regulations balance the need for consumer protection, regulatory enforcement, and fairness to schools. They seek to hold schools accountable, provide prospective and continuing students with information necessary to make informed choices, and mitigate actions that pose an existential threat to institutions. A school's precipitous closure—as opposed to a well-planned, accreditor approved teach-out—puts students, borrowers, and taxpayers at unnecessary risk.

Further, through these proposed regulations, the Department seeks to encourage schools that are closing to go through an orderly closure, which includes offering appropriate teach-outs to their students. Since 2015, precipitous closures have led to large numbers of defense to repayment and closed school discharge applications. We believe that closing schools should be encouraged to offer accreditor-approved and, if applicable, State authorizer-approved teach-out plans. Such plans allow students the reasonable opportunity to complete their academic programs, either at another location after the school has closed or through an orderly wind-down process before the school officially closes.

We also propose changes to the Department's current false certification regulations. The Department believes that in cases when the borrower is unable to obtain an official transcript or diploma from the high school, postsecondary institutions should be able to rely on an attestation from a borrower that the borrower earned a high school diploma since the Department relies on a similar attestation in processing a student's Free Application for Federal Student Aid (FAFSA). This policy change provides assurances to students that they will have a reasonable opportunity to pursue postsecondary education when they cannot obtain an official transcript or diploma, and to institutions that they will not face significant liabilities years later if a student's status cannot be verified. Therefore, we are proposing regulatory language that when a borrower provides an institution an attestation of his or her high school graduation status for purposes of admission to the institution, the borrower may not subsequently qualify for a false certification discharge based on not having a high school diploma.

We do not propose to adopt the changes relating to pre-dispute arbitration agreements and class action waivers that are in the 2016 final regulations. In those regulations, the Department took the position that the HEA gives the Department broad authority to impose conditions on schools that wish to participate in a Federal benefit program and that regulation of the use of pre-dispute arbitration agreements and class action waivers was necessary to ''protect the interests of the United States and promote the purposes'' of the Direct Loan Program under Section 454(a)(6) of the HEA, 20 U.S.C. 1087d(a)(6). We continue to recognize, as explained in the preamble to the 2016 final regulations, that pre-dispute arbitration agreements and class action waivers, in some circumstances, may not be well understood by consumers and may not facilitate the Department's awareness of potential issues faced by students at a school. However, in re-weighing all applicable factors, including the current legal landscape, we have determined that the Department should take a position more in line with the benefits of arbitration and the strong Federal policy favoring it.

Several potential benefits of arbitration are relevant here. Arbitration is often a more efficient and less adversarial means of dispute resolution than time-consuming and expensive litigation that may result in borrowers waiting years to obtain a fair hearing and any relief. Arbitration may also allow borrowers to obtain greater relief than they would in a consumer class action case where attorneys often benefit most. Moreover, arbitration may reduce the expense of litigation that a university would otherwise pass on to students in the form of higher tuition and fees. Arbitration also eases burdens on the overtaxed U.S. court system.

For all of these reasons, the Department has decided that the 2016 final regulations' provisions on class action waivers and pre-dispute arbitration should not be included in these proposed regulations. As stated above, we believe that borrower defense to repayment should be a last resort for borrowers. Arbitration is one means of dispute resolution through which borrowers may be able to obtain relief without filing a defense to repayment

with the Department. The Department does not propose to prevent that means. But because pre-dispute arbitration agreements or class-action waivers may limit the availability of certain alternative means of dispute resolution, we propose changes that would provide borrowers with a better understanding of the dispute resolution processes available to them when they enroll at a school.

The proposed regulations also update the appendices to subpart L of 34 CFR part 668 to account for changes in accounting standards and terminology.

Incorporation by Reference

In proposed § 668.175(d) with respect to the zone alternative, we reference the following accounting standards: FASB ASC 850, Accounting Standards Update (ASU) 2015–01, and ASC 225. FASB ASC 850 addresses disclosures of transactions between related parties. These disclosures are considered to be related party transactions even though they may not be given accounting recognition. While not providing accounting or measurement guidance for such transactions, FASB ASC 850 requires their disclosure nonetheless.

Accounting Standards Update (ASU) No. 2015–01 addresses extraordinary and unusual items, to simplify income statement classification by removing the concept of extraordinary items from United States generally accepted accounting principles (U.S. GAAP).

ASC 225 provides general income statement guidance. Specifically, it addresses the classification and resulting presentation and disclosure of extraordinary events and transactions. It also addresses the presentation and disclosure of unusual and infrequently occurring items that do not meet the extraordinary criteria, and speaks to business interruption insurance. The types of costs and losses covered by business interruption insurance typically include items such as gross margin that was lost or not earned due to the suspension of normal operations.

These items are accessible to the public on the Financial Accounting Standards Board (FASB) website, *www.fasb.org.*

Summary of the Major Provisions of This Regulatory Action:

For the Direct Loan Program, we propose new regulations governing borrower defenses that would—

- Establish a new Federal standard for borrower defenses to repayment submitted by borrowers with loans first disbursed on or after July 1, 2019;
- Establish a process for the assertion and resolution of borrower defenses to repayment for loans first disbursed on or after July 1, 2019;
- Provide schools and borrowers with opportunities to provide evidence and arguments when a defense to repayment application has been filed and to provide an opportunity for each to respond to the other's submitted evidence;
- Require a borrower to sign an attestation to ensure that financial harm is not the result of the borrower's workplace performance, disqualification for a job for reasons unrelated to the education received, a personal decision to work less than full-time or not at all, or the borrower's decision to change careers.
- Establish a time limit for the Secretary to initiate an action to collect from the responsible school the amount of any loans first disbursed on or after July 1, 2019, that are subject to a successful borrower defense to repayment discharge for which the school is liable;
- Provide for remedial actions the Secretary may take to collect from the responsible school the amount of any loans subject to a successful borrower defense to repayment discharge for which the school is liable; and
- Establish institutional responsibility and financial liability for losses incurred by the Secretary for repayment of loan amounts discharged by the Secretary on the basis of a borrower defense to repayment discharge.

The proposed regulations would also revise the Student Assistance General Provisions regulations to—

- Provide for schools that require Federal student loan borrowers to sign pre-dispute arbitration agreements or class action waivers as a condition of enrollment to make a plain language disclosure of those requirements to prospective and enrolled students and place that disclosure on its website where information regarding admissions and tuition and fees is presented; and
- Provide for schools that require Federal student loan borrowers to sign pre-dispute arbitration agreements or class action waivers as a condition of enrollment to include information in the borrower's entrance counseling regarding the school's internal dispute and arbitration processes.
- Amend the financial responsibility provisions to establish the conditions or events that have or may have an adverse material effect on an institution's financial condition and which warrant financial protection for the Department, update the definitions of terms used to calculate an institution's composite score to conform with changes in accounting standards but provide a six year phase-in to enable the Department adequate time to update the Composite Score regulations accordingly through future negotiated rulemaking, and expand the types of financial protection acceptable to the Secretary.

The proposed regulations would also—

- Revise the Perkins Loan, FFEL, and Direct Loan programs' closed school discharge regulations to extend the window for a borrower to qualify for a closed school discharge to 180 days;
- Revise the Perkins Loan, FFEL, and Direct Loan programs' closed school discharge regulations to specify that if a closing school provides an opportunity to complete the program of study approved by the school's accrediting agency and, if applicable, the school's State authorizing agency, the borrower would not qualify for a closed school discharge;
- Modify the conditions under which a Direct Loan borrower may qualify for a false certification discharge by specifying that, in cases when the borrower could not reasonably provide the school an official transcript or diploma from the borrower's high school, but provided an attestation to the school that the borrower was a high school graduate, the borrower would not qualify for a false certification discharge based on not having a high school diploma;
- Prohibit guaranty agencies from charging collection costs to a defaulted borrower who enters into a repayment agreement with the guaranty agency within 60 days of receiving notice of default from the agency;
- Prohibit guaranty agencies from capitalizing interest on a loan that is sold following the completion of loan rehabilitation;
- Reflect the Department's policy regarding the impact that a discharge of a Direct Subsidized Loan has on the 150 Percent Direct Subsidized Loan Limit; and
- Update composite score calculations to reflect recent changes in FASB accounting standards and provide for a six year phase-in process to provide the Department sufficient time to update the Composite Score regulations accordingly through negotiated rulemaking.

In addition, for the reasons set forth below, we propose to withdraw (*i.e.,* rescind) specified provisions of the final regulations we published on November 1, 2016 (81 FR 75926) (the 2016 final regulations) that were delayed until July 1, 2019, pertaining to borrower defenses to repayment and related issues.

Please refer to the *Summary of Proposed Changes* section of this notice of proposed rulemaking (NPRM) for more details on the major provisions contained in this NPRM.

Costs and Benefits: As further detailed in the *Regulatory Impact Analysis,* the benefits of the proposed regulations include: (1) An updated and clarified process and the creation of a Federal standard to streamline the administration of defense to repayment applications; (2) improved financial protections for the Federal government and taxpayers by requiring institutions to incur the losses associated with a successful defense to repayment application and reducing the likelihood of taxpayers incurring costs related to paying claims submitted by students who were not harmed; (3) additional information to help students, prospective students, and their families make educated decisions based on information about a school's mandatory arbitration or class action waiver requirements and to effectively use arbitration when necessary; (4) an extended window for a borrower to qualify for a closed school discharge and revisions incentivizing completion of educational programs; (5) revised conditions under which a Direct Loan borrower may qualify for a false certification discharge to ensure that students who are unable to obtain a high school transcript have an opportunity to participate in postsecondary education and that a student's intentional misrepresentation of his or her high school graduation status cannot then be used to justify a false certification discharge; (6) restrictions on guaranty agencies from charging collection costs to a defaulted borrower who enters into a repayment agreement with the guaranty agency within 60 days of receiving notice of default from the agency, and from capitalizing interest on a loan that is sold following the completion of loan rehabilitation; (7) recalculating subsidized usage periods, as appropriate, when a borrower has received a loan discharge; and (8) updating the calculation of composite scores to reflect changes in FASB standards, but also providing a six-year phase in to provide time for the Department to update its composite score regulations through future negotiated rulemaking.

Costs include the paperwork burden associated with the required reporting and disclosures to ensure compliance with the proposed regulations, the cost to affected schools of providing financial protection, and the cost to taxpayers of borrower defense claims that are not reimbursed by schools. There may also be costs to borrowers who may be reluctant to go into default, even if they have a claim that would result in loan relief or partial loan relief, and therefore do not benefit from that loan relief. There may also be costs to borrowers who use the legal system to seek damages from an institution rather than relying on the government to adjudicate consumer complaints.

Invitation to Comment: We invite you to submit comments regarding these proposed regulations.

To ensure that your comments have maximum effect in developing the final regulations, we urge you to identify clearly the specific section or sections of the proposed regulations that each of your comments addresses, and provide relevant information and data whenever possible, even when there is no specific solicitation of data and other supporting materials in the request for comment. We also urge you to arrange your comments in the same order as the proposed regulations. Please do not submit comments that are outside the scope of the specific proposals in this NPRM, as we are not required to respond to such comments.

We invite you to assist us in complying with the specific requirements of Executive Orders 12866 and 13563 and their overall requirement of reducing regulatory burden that might result from these proposed regulations. Please let us know of any further ways we could reduce potential costs or increase potential benefits while preserving the effective and efficient administration of the Department's programs and activities.

During and after the comment period, you may inspect all public comments about the proposed regulations by accessing *Regulations.gov.* You may also inspect the comments in person at 400 Maryland Ave. SW, Washington, DC, between 8:30 a.m. and 4:00 p.m., Eastern Time, Monday through Friday of each week except Federal holidays. To schedule a time to inspect comments, please contact one of the persons listed under **FOR FURTHER INFORMATION CONTACT.**

Assistance to Individuals with Disabilities in Reviewing the Rulemaking Record: On request, we will provide an appropriate accommodation or auxiliary aid to an individual with a disability who needs assistance to review the comments or other documents in the public rulemaking record for the proposed regulations. To schedule an appointment for this type of accommodation or auxiliary aid, please contact one of the persons listed under **FOR FURTHER INFORMATION CONTACT.**

Background

The Secretary proposes to amend parts 668, 674, 682, and 685 of title 34 of the Code of Federal Regulations (CFR). The regulations in 34 CFR part 668 pertain to Student Assistance General Provisions. The regulations in 34 CFR part 674 pertain to the Perkins Loan Program. The regulations in 34 CFR part 682 pertain to the FFEL Program. The regulations in 34 CFR part 685 pertain to the Direct Loan Program.

We are proposing these amendments to: (1) Specify that the standard used to identify an act or omission of a school that provides the basis for a borrower defense to repayment discharge will depend on when the Direct Loan was first disbursed; (2) establish a new Federal standard that the Department will use to determine whether a school's act or omission constitutes a basis for a borrower defense to repayment discharge for loans disbursed on or after July 1, 2019; (3) provide an opportunity for an institution to know that a defense to repayment application has been lodged against it and to respond to claims made in that application; (4) establish the procedures to be used by a borrower to initiate a borrower defense to repayment application for loans first disbursed on or after July 1, 2019; (5) establish a time limit for the Secretary to initiate action to collect from the responsible school the amount of any loans first disbursed on or after July 1, 2019 that are subject to an approved borrower defense to repayment discharge; (6) establish the procedures that the Department would use to determine the liability of a school for the amount of any loan discharges and reimbursement of loan payments resulting from successful borrower defenses to repayment; (7) establish the conditions or events upon which an institution is or may be required to provide to the Department financial protection, such as a letter of credit, to help protect the Federal government and taxpayers, against potential institutional liabilities; (8) institute requirements to ensure borrowers are informed and educated about pre-dispute arbitration agreements and class action waivers that students are required to sign by the school as a condition of enrollment; (9) revise the closed school discharge regulations to extend the window for a borrower to qualify for a closed school discharge and specify that if a closing school provides a borrower an opportunity to complete his or her academic program through a teach-out plan approved by the school's accrediting agency and, if applicable, the school's State

authorizing agency, the borrower would not qualify for a closed school discharge; (10) amend the eligibility criteria for the false certification loan discharge by specifying that, in cases when a borrower could not provide the school an official high school transcript or diploma but provided an attestation that the borrower was a high school graduate, the borrower would not qualify for a false certification discharge based on not having a high school diploma; (11) clarify the conditions under which FFEL Program loan holders may capitalize the interest due on a loan to be consistent with the Department's practice for loans it holds; (12) reflect the conditions under which the discharge of a Direct Subsidized Loan will lead to the elimination or recalculation of a Subsidized Usage Period under the 150 Percent Direct Subsidized Loan Limit or the restoration of interest subsidy; and (13) prohibit guaranty agencies from charging collection costs if a borrower enters into a repayment agreement within 60 days of the default notice.

Public Participation

On June 16, 2017, we published a notification in the **Federal Register** (82 FR 27640) announcing our intent to establish a negotiated rulemaking committee under section 492 of the HEA to revise the regulations on borrower defenses to repayment of Federal student loans and other matters, and on the authority of guaranty agencies in the FFEL Program to charge collection costs to defaulted borrowers under 34 CFR 682.410(b)(6). We also announced two public hearings at which interested parties could comment on the topics suggested by the Department and suggest additional topics for consideration for action by the negotiated rulemaking committee. The hearings were held on—

July 10, 2017, in Washington, DC; and

July 12, 2017, in Dallas, TX.

Transcripts from the public hearings are available at *www2.ed.gov/policy/highered/reg/hearulemaking/2017/index.html.*

We also invited parties unable to attend a public hearing to submit written comments on the proposed topics and to submit other topics for consideration. Written comments submitted in response to the June 16, 2017, **Federal Register** notification may be viewed through the Federal eRulemaking Portal at *www.regulations.gov,* within docket ID ED–2017–OPE–0076. Instructions for finding comments are also available on the site under ''How to Use *Regulations.gov*'' in the Help section.

On August 30, 2017, we published a notification in the **Federal Register** (82 FR 41194) requesting nominations for negotiators to serve on the negotiated rulemaking committee and setting a schedule for committee meetings.

Negotiated Rulemaking

Section 492 of the HEA, 20 U.S.C. 1098a, requires the Secretary to obtain public involvement in the development of proposed regulations affecting programs authorized by title IV of the HEA. After obtaining extensive input and recommendations from the public, including individuals and representatives of groups involved in the title IV, HEA programs, the Secretary in most cases must subject the proposed regulations to a negotiated rulemaking process. If negotiators reach consensus on the proposed regulations, the Department agrees to publish without alteration a defined group of regulations on which the negotiators reached consensus unless the Secretary reopens the process or provides a written explanation to the participants stating why the Secretary has decided to depart from the agreement reached during negotiations. Further information on the negotiated rulemaking process can be found at: *www2.ed.gov/policy/highered/reg/hearulemaking/hea08/neg-reg-faq.html.*

On August 30, 2017, the Department published a notification in the **Federal Register** (82 FR 41194) announcing its intention to establish two negotiated rulemaking committees and a subcommittee to prepare proposed regulations governing the Federal Student Aid programs authorized under title IV of the HEA. One negotiated rulemaking committee was established to propose regulations relating to gainful employment and the other to propose regulations pertaining to borrower defenses to repayment of Federal student loans, the definition of misrepresentation as it pertains to borrower defense, the program participation agreement for schools participating in the title IV programs, closed school and false certification loan discharges, financial responsibility and administrative capability, arbitration and class action lawsuits, revisions to regulations that will address whether and to what extent guaranty agencies may charge collection costs under 34 CFR 682.410(b)(6) to a defaulted borrower who enters into a loan rehabilitation or other repayment agreement within 60 days of being informed that the guaranty agency has paid a claim on the loan.

A subcommittee, which was composed of individuals with expertise in the applicable financial accounting and reporting standards set by the Financial Accounting Standards Board (FASB), was established to discuss whether and how the (FASB's) recent changes to the accounting standards for financial reporting affected financial reporting requirements for schools and to recommend appropriate regulatory changes to the negotiated rulemaking committee.

The notification set forth a schedule for the committee meetings and requested nominations for individual negotiators to serve on the negotiating committee and the subcommittee. The Department sought negotiators to represent the following groups: Students and former students; consumer advocacy organizations; legal assistance organizations that represent students and former students; groups representing U.S. military service members or veteran Federal student loan borrowers; financial aid administrators at postsecondary schools; general counsels/attorneys and compliance officers at postsecondary schools; chief financial officers (CFOs) and experienced business officers at postsecondary schools; State attorneys general and other appropriate State officials; State higher education executive officers; institutions of higher education eligible to receive Federal assistance under title III, parts A, B, and F, and title V of the HEA, which include Historically Black Colleges and Universities, Hispanic-Serving Institutions, American Indian Tribally Controlled Colleges and Universities, Alaska Native and Native Hawaiian-Serving Institutions, Predominantly Black Institutions, and other institutions with a substantial enrollment of needy students as defined in title III of the HEA; two-year public institutions of higher education; four-year public institutions of higher education; private, nonprofit institutions of higher education; private, proprietary institutions of higher education; FFEL Program lenders and loan servicers; FFEL Program guaranty agencies and guaranty agency servicers (including collection agencies); and accrediting agencies. The Department sought subcommittee members to represent the following constituencies who also have expertise in the applicable financial accounting and reporting standards set by the Financial Accounting Standards Board (FASB): Private, nonprofit institutions of higher education, with knowledge of the accounting standards and title IV financial responsibility

requirements for the private, nonprofit sector; private, proprietary institutions of higher education, with knowledge of the accounting standards and title IV financial responsibility requirements for the proprietary sector; accrediting agencies; chief financial officers (to include experienced business officers and bursars) at postsecondary institutions; associations or organizations that provide accounting guidance to auditors and institutions; certified public accountants or firms who conduct financial statement audits of title IV participating institutions; and FASB. The Department considered the nominations submitted by the public and chose negotiators who would represent the various constituencies.

The negotiating committee included the following members: Joseline Garcia, United States Students Association, and Stevaughn Bush, (alternate) Student, Howard University School of Law, representing students and former students.

Ashley Harrington, Center for Responsible Lending, and Suzanne Martindale (alternate), Consumers Union, representing consumer advocacy organizations.

Abby Shafroth, National Consumer Law Center, and Juliana Fredman, (alternate) Bay Area Legal Aid, representing legal assistance organizations that represent students.

Will Hubbard, Student Veterans of America, and Walter Ochinko (alternate), Veterans Education Success, representing U.S. military service members or veterans.

Valerie Sharp, Evangel University, and Kimberly Brown (alternate), Des Moines University, representing financial aid administrators.

Aaron Lacey, Partner, Thomas Coburn LLP, and Bryan Black, (alternate), Attorney, representing General Counsels/attorneys and compliance officers.

Kelli Hudson Perry, Rensselaer Polytechnic Institute, and Dawnelle Robinson (alternate), Roanoke Chowan Community College, representing CFOs and business officers.

John Ellis, State of Texas Office of the Attorney General, and Evan Daniels (alternate), Office of the Arizona Attorney General, representing State attorneys general and other appropriate State officials.

Robert Flanigan, Jr., Spelman College, and Lodriguez Murray (alternate), United Negro College Fund, representing minority serving institutions.

Dan Madzelan, American Council on Education, and Barmak Nassirian (alternate), American Association of State Colleges and Universities, representing two-year public institutions.

Alyssa Dobson, Slippery Rock University, and Kay Lewis (alternate), University of Washington, representing four-year public institutions.

Ashley Ann Reich, Liberty University, and Gregory Jones (alternate), Compass Rose Foundation, representing private, non-profit institutions.

Mike Busada, Ayers Career College, and Chris DeLuca (alternate), DeLuca Law LLC, representing private, proprietary institutions with enrollment of 450 students or fewer.

Michael Bottrill, SAE Institute North America, and Linda Rawles, (alternate) Rawles Law, representing private, proprietary institutions with enrollment of 451 students or more.

Wanda Hall, Edfinancial Services, and Colleen Slattery (alternate), MOHELA, representing FFEL Program lenders and loan servicers.

Jaye O'Connell, Vermont Student Assistance Corporation, and Sheldon Repp (alternate), National Council of Higher Education Resources, representing FFEL Program guaranty agencies and guaranty agency servicers.

Dr. Michale McComis, Accrediting Commission of Career Schools and Colleges, and Karen Peterson Solinski, (alternate), Higher Learning Commission, representing accreditors.

Annmarie Weisman, U.S. Department of Education, representing the Department.

The subcommittee included the following members:

John Palmucci, Maryland University of Integrative Health, representing private, non-profit institutions.

Jonathan Tarnow, Drinker Biddle & Reath LLP, representing private, proprietary institutions.

Dr. Julianne Marie Malveaux, Economic Education, and formerly of Bennett College, representing minority serving institutions.

Dale Larson, Dallas Theological Seminary, representing Accrediting agencies.

Dawnelle Robinson, Shaw University, representing CFOs, business officers, and bursars.

Susan M. Menditto, National Association of College and University Business Officers, representing organizations that provide accounting guidance to auditors and institutions.

Ronald E. Salluzzo, Attain, representing Certified public accountants or firms who conduct compliance audits and/or prepare financial statements of participating Title IV institutions.

Jeffrey Mechanick, the Financial Accounting Standards Board (FASB), representing FASB.

The negotiated rulemaking committee met to develop proposed regulations on November 13–15, 2017, January 8–11, 2018, and February 12–15, 2018. The subcommittee met in person on November 16–17, 2017, January 4–5, 2018, and by telephone on January 30, 2018.

At its first meeting, the negotiating committee reached agreement on its protocols and proposed agenda. The protocols provided, among other things, that the committee would operate by consensus. Consensus means that there must be no dissent by any member in order for the committee to have reached agreement. Under the protocols, if the committee reached a final consensus on all issues, the Department would use the consensus-based language in its proposed regulations. Furthermore, the Department would not alter the consensus-based language of its proposed regulations unless the Department reopened the negotiated rulemaking process or provided a written explanation to the committee members regarding why it decided to depart from that language.

During the first meeting, the negotiating committee agreed to negotiate an agenda of eight issues related to student financial aid. These eight issues were: Borrower defense to repayment standard; the process for applying for and considering borrower defense claims; financial responsibility and administrative capability; pre-dispute arbitration agreements, class action waivers, and internal dispute processes; closed school discharges; false certification discharges; guaranty agency collection fees; and subsidized usage period recalculations.

During committee meetings, the negotiators reviewed and discussed the Department's drafts of regulatory language and the committee members' alternative language and suggestions. At the final meeting on February 15, 2018, the committee did not reach consensus on the Department's proposed regulations. For that reason, and according to the committee's protocols, all parties who participated in or who were represented in the negotiated rulemaking, in addition to all members of the public, may comment freely on the proposed regulations. For more information on the negotiated rulemaking sessions, please visit: *www2.ed.gov/policy/highered/reg/hearulemaking/2017/borrowerdefense.html.* Transcripts and audio recordings of the negotiated rulemaking session are also available at:

www2.ed.gov/policy/highered/reg/hearulemaking/2017/borrowerdefense.html.

While transcripts have been made available by the Department to aid public understanding of the negotiated rulemaking proceedings, the transcripts have not been vetted or reviewed for accuracy or completeness and should not be considered as the Department's official transcription of the negotiated rulemaking proceedings.

Summary of Proposed Changes

The proposed regulations would—

- Rescind specified provisions of the 2016 final regulations, which have not yet become effective.
- Amend § 668.41 to require schools that require students to accept pre-dispute arbitration agreements or class action waivers as a condition of enrollment to disclose that information to students, prospective students, and the public in an easily accessible format;
- Amend § 668.91 to 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;
- Amend § 668.94 to 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;
- Amend § 668.171 to 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;
- Amend § 668.172 to address changes to the accounting standards regarding leases;
- Amend § 668.175 to expand the types of financial protection acceptable to the Secretary;
- Amend §§ 674.33, 682.402 and 685.214 to extend the window for a borrower to qualify for a closed school discharge and to specify that if a closing school provided a borrower the reasonable opportunity to complete his or her academic program through an orderly school closure or a teach-out plan and that is approved by the school's accrediting agency and, if applicable, the school's State authorizing agency, the borrower will not qualify for a closed school discharge;
- Amend §§ 682.202, 682.405, and 682.410 to prohibit guaranty agencies and FFEL Program lenders from capitalizing the outstanding interest on a FFEL loan when the borrower rehabilitates a defaulted FFEL loan;
- Amend § 682.405 to prohibit guaranty agencies and FFEL Program lenders from charging collections costs when a borrower enters into a repayment agreement within 60 days of the notice of default;
- Amend § 685.200 to 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;
- Amend § 685.206 to clarify that existing regulations with regard to borrower defenses to repayment apply to loans first disbursed prior to July 1, 2019; to establish a Federal standard for deciding borrower defenses to repayment pertaining to a loan first disbursed on or after July 1, 2019; to establish the procedures that the Department would use to determine the liability of a school for the amount of any loan discharges resulting from borrower defense claims pertaining to loans first disbursed on or after July 1, 2019; and to provide that the Secretary may initiate a proceeding to recover from an institution the amount of any loan discharged by the Secretary based on a defense to repayment within five years of the date of the final decision to discharge the loan.
- Amend § 685.212 to add borrower defense to repayment discharges to the discharge provisions listed in this section.
- Amend § 685.215 to provide that in cases when a Direct Loan borrower could not obtain an official transcript or diploma from high school and instead provided an attestation to the institution that the borrower was a high school graduate, the borrower will not qualify for a false certification discharge based on not having a high school diploma.
- Amend § 685.300 to 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.
- Amend § 685.304 to require institutions that use pre-dispute arbitration agreements or class action waivers to provide written, plain language descriptions of those agreements and to provide the student borrower with written information on how to use the school's internal dispute resolution process.
- Amend § 685.308 to 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, pursuant to §§ 685.206, 685.214, and 685.216.

Significant Proposed Regulations

We discuss substantive issues under the sections of the proposed regulations to which they pertain. Generally, we do not address proposed regulatory provisions that are technical or otherwise minor in effect.

In 2016, the Department conducted negotiated rulemaking and published the 2016 final regulations on the topic of borrower defenses to repayment and related issues, but those regulations have not yet gone into effect. On June 16, 2017, the Department published in the **Federal Register** a notification of the partial delay of effective dates under section 705 of the Administrative Procedure Act (5 U.S.C. 705) (82 FR 27621) (705 Notification), for certain provisions of the final regulations until a legal challenge by the California Association of Private Postsecondary Schools is resolved. *See* Complaint and Prayer for Declaratory and Injunctive Relief, *California Association of Private Postsecondary Schools* v. *DeVos*, Civil Action No. 1:17-cv-00999 (D.D.C. May 24, 2017). Subsequently, we published an interim final rule (82 FR 49114), which gave notice that after the 705 notification delayed implementation past July 1, 2017, pursuant to the Department's interpretation of the master calendar requirement, the earliest the regulation could go into effect was July 1, 2018. Then, on February 14, 2018, following a notice of proposed rulemaking, the Department published a final rule establishing July 1, 2019, as the effective date of the 2016 final regulations (83 FR 6458).

We now propose rescission of the 2016 final regulations that we delayed through previous notification. In this preamble, we describe the proposed changes to the regulations based on the currently effective regulations and not the delayed provisions of the 2016 final regulations. In light of the withdrawal (*i.e.* rescission) of the delayed provisions of the 2016 final regulations, this approach is required under 1 CFR part 21, which provides that each agency that drafts regulations must do so as an amendment to the Code of Federal Regulations. The currently effective regulations, not the delayed provisions of the 2016 final regulations, are the provisions codified in the Code of Federal Regulations. Thus, we are

amending the currently effective regulations, not the delayed provisions of the 2016 final regulations, in this NPRM. Throughout the ''Significant Proposed Regulations'' section of this NPRM, we describe our reasoning for the proposed rescissions in the context of the topics to which they pertain. For purposes of determining the budget impact of the regulation, we utilize the 2019 President's Budget Request, which assumed the implementation of the 2016 regulation.

Please note that the following two issues in the 2016 final regulations are being addressed through a separate rulemaking process focused on the Gainful Employment regulations process: The requirement that proprietary schools at which the median borrower has not repaid in full, or paid down by at least one dollar the outstanding balance of, the borrower's loans to provide a Department-issued plain language warning in promotional materials and advertisements; and the requirement for a school to disclose on its website and to prospective and enrolled students if it is required to provide financial protection, such as a letter of credit, to the Department. The Department felt that the Gainful Employment rulemaking was the appropriate place to propose and discuss eliminating these disclosures because the Gainful Employment negotiated rulemaking committee addressed other regulations on disclosures.

Thus, in this NPRM, we propose rescinding the revisions to or additions to the following regulations:

Section 668.14(b)(30), (31), and (32) Program participation agreement.

Section 668.41(h) and (i) Reporting and disclosure of information.

Section 668.71(c) Scope and special definitions.

Section 668.90(a)(3) Initial and final decisions.

Section 668.93(h), (i) and (j) Limitation.

Section 668.171 General.

Section 668.175(c), (d), (f), and (h) Alternative standards and requirements.

Part 668, subpart L, appendix C.

Section 674.33(g)(3) and (8) Repayment.

Section 682.202(b)(1) Permissible charges by lenders to borrowers.

Section 682.211(i)(7) Forbearance.

Section 682.402(d)(3), (d)(6)(ii)(B)(*1*) and (*2*), (d)(6)(ii)(F) introductory text, (d)(6)(ii)(F)(*5*), (d)(6)(ii)(G), (d)(6)(ii)(H) through (K), (d)(7)(ii) and (iii), (d)(8), and (e)(6)(iii) Death, disability, closed school, false certification, unpaid refunds, and bankruptcy payments.

Section 682.405(b)(4)(ii) Loan rehabilitation agreement.

Section 682.410(b)(4) and (b)(6)(viii) Fiscal, administrative, and enforcement requirements.

Section 685.200(f)(3)(v) and (f)(4)(iii) Borrower eligibility.

Section 685.205(b)(6) Forbearance.

Section 685.206(c) Borrower responsibilities and defenses.

Section 685.212(k) Discharge of a loan obligation.

Section 685.214(c)(2), (f)(4) through (7) Closed school discharge.

Section 685.215(a)(1), (c) introductory text, (c)(1) through (8), and (d) Discharge for false certification of student eligibility or unauthorized payment.

Section 685.222 Borrower defenses.

Part 685 subpart B, appendix A Examples of borrower relief.

Section 685.300(b)(11) and (12) and (d) through (i) Agreements between an eligible school and the Secretary for participation in the Direct Loan Program.

Section 685.308(a) Remedial actions.

Note: Section 668.90 has been redesignated as § 668.91 and § 668.93 has been redesignated as § 668.94 pursuant to the borrower defense procedural rule, published January 19, 2017 at 82 FR 6253 (the borrower defense procedural rule).

Borrower Defenses—General (§ 685.206)

Background: Section 455(h) of the HEA authorizes the Secretary to specify which acts or omissions of an institution of higher education a borrower may assert as a defense to the repayment of a Direct Loan. 20 U.S.C. 1087e(h). Under the Department's current regulations at § 685.206(c), a borrower may assert as a defense against repayment of a loan in response to a proceeding by the Department to collect on a Direct Loan, any act or omission of the school attended by the student directly and clearly related to the making of a Direct Loan for enrollment at the institution or the provision of educational services for which the loan was made that would give rise to a cause of action against the school under applicable State law (referred to in this document as the ''State law standard'').

The Department first promulgated the Direct Loan Program's borrower defense to repayment regulation December 1, 1994 (59 FR 61664, 61696), which became effective on July 1, 1995. 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 FFEL Loan 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 § 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 (*see www.ed.gov/news/press-releases/fact-sheet-protecting-students-abusive-career-colleges* and *https://studentaid.ed.gov/sa/about/announcements/corinthian*) that it would consider affirmative borrower defense claims.

The current regulation does not set forth the process a borrower may use to assert an affirmative borrower defense claim. Therefore, 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, given the time it takes to adjudicate each claim, and costly to taxpayers.

The Department is considering whether to allow only defensive claims or to continue the approach taken in its 2015 interpretation that allowed it to accept both defensive and affirmative claims. One regulatory alternative, specified in the proposed amendatory language, continues to provide a remedy to borrowers in a collections proceeding, as has been the case since the borrower defense to repayment regulation was promulgated in 1994, by permitting borrowers to assert defense to repayment during a proceeding by the Department to collect on a Direct Loan including, but not limited to, tax refund offset proceedings under 34 CFR 30.33, wage garnishment proceedings under section 488A of the HEA, salary offset proceedings for Federal employees under 34 CFR part 31, and consumer reporting proceedings under 31 U.S.C. 3711(f).

The other regulatory alternative, specified in the proposed amendatory language, would allow for both affirmative claims from borrowers not in a collections action and defensive claims. If we do accept affirmative claims, we would need to develop appropriate deterrents to frivolous claims. At a minimum, the Department

would revise the affirmative claim review process to provide institutions with a reasonable opportunity to see and respond to borrower claims and would require the borrower to sign a waiver that allows the institutions to provide the Department with any information from the borrower's education record that is relevant to the claim. The Department could also limit the period of time after a borrower leaves an institution during which a borrower could make an affirmative claim. Given the Department's long-standing requirement that institutions retain certain documents for only three years, the Department could limit claims to the three-year period following the borrower's departure from the institution to ensure that the institution would have access to records that could be relevant to their defense. The Department seeks public comment on ways to balance the need to serve borrowers with the need to limit unsubstantiated claims and provide an opportunity for the institution to provide evidence in its own defense.

Borrower Defense to Repayment—Assertion of Defenses to Repayment in Collection Proceedings and Federal Standard for Asserting a Borrower Defense to Repayment

Statute: Section 455(h) of the HEA authorizes the Secretary to specify in regulation which acts or omissions of an institution of higher education a borrower may assert as a defense to repayment of a Direct Loan.

Current Regulations: Section 685.206(c) establishes the conditions under which a Direct Loan borrower may assert a defense to repayment, the relief afforded by the Secretary in the event the defense is successful, and the Secretary's authority to recover from the school any loss that results from a defense to repayment discharge granted by the Department. Specifically, § 685.206(c)(1) provides that a borrower may assert a defense to repayment based upon any act or omission of the school that would give rise to a cause of action against the school under applicable State law. The borrower may raise such defense to repayment during a proceeding by the Department to collect on a Direct Loan, including, but not limited to, tax refund offset proceedings under 34 CFR 30.33, wage garnishment proceedings under section 488A of the HEA, salary offset proceedings for Federal employees under 34 CFR part 31, and consumer reporting proceedings under 31 U.S.C. 3711(f). Under the current regulations, since 2015, the Department has accepted affirmative claims, *i.e.,* those not in collection proceedings. Under 34 CFR 685.206(c)(2), if a borrower defense to repayment discharge is approved, the borrower is relieved of the obligation to pay all or part of the loan and associated costs and fees, and may be afforded such further relief as the Secretary determines is appropriate, including, among other things, reimbursement of amounts previously paid toward the loan.

Proposed Regulations: Proposed § 685.206(c) would specify that, with respect to Direct Loans disbursed prior to July 1, 2019, the State law standard would continue to apply. Proposed paragraph (c) maintains that a borrower defense to repayment of these loans may be asserted in proceedings including, but not limited to, tax refund offset proceedings, wage garnishment proceedings, salary offset proceedings for Federal employees, and consumer reporting agency reporting proceedings, but includes clarifications as to statutory and regulatory authorities for those specified proceedings.

Proposed § 685.206(d) would establish a new uniform standard not based upon applicable State law, also referred to here as the ''Federal standard'' for a borrower's defense to repayment discharge on a Direct Loan first disbursed on or after July 1, 2019. First, § 685.206(d)(1) would define terms applicable to the Federal standard, including the term ''borrower defense to repayment.'' Consistent with the Department's current interpretation that it is not appropriate for the taxpayer to face potential loss based on action by schools in matters unrelated to the Department's loan programs, this definition would provide that a borrower defense to repayment discharge must directly and clearly relate to the making of the Direct Loan, or the making of a loan that was repaid by a Direct Consolidation Loan, for enrollment at a school or the provision of educational services for which the loan was obtained. In addition, we clarify that for the purposes of this paragraph, ''borrower'' includes the student who attended the institution for whom Direct Loans (Parent PLUS) were obtained by a parent. Further, under this proposed definition, a ''borrower defense to repayment'' would be considered to include both a defense to repayment of amounts owed to the Secretary on a Direct Loan and reimbursement of payments previously made to the Secretary on the Direct Loan. Proposed § 685.206(d)(1) also would define the terms ''provision of educational services'' and ''school'' and ''institution.''

Parallel to the current regulation, the proposed regulations provide that for loans first disbursed on or after July 1, 2019, a borrower may assert a defense to repayment ''defensive'' claim as part of a proceeding related to certain actions by the Department to collect on a Direct Loan, including tax refund offset proceedings under 26 U.S.C. 6402(d), 31 U.S.C. 3716 and 3720A; wage garnishment proceedings under section 488A of the Act or under 31 U.S.C. 3720D and 34 CFR part 34; salary offset proceedings for Federal employees under 34 CFR part 31, 5 U.S.C. 5514, and 31 U.S.C. 3716; and consumer reporting agency reporting proceedings under 31 U.S.C. 3711(e). This language is reflected in proposed § 685.206(d)(2)—Alternative A.

The Department is also considering accepting ''affirmative'' claims from borrowers not in a collections action. Proposed regulatory language for this approach is set forth in § 685.206(d)(2)—Alternative B. Like Alternative A, Alternative B proposes to consider both affirmative and defensive claims under a preponderance of the evidence standard. But the Department seeks comment on whether claims under this regulatory alternative should have to be supported by clear and convincing evidence, rather than a preponderance of the evidence. Such a standard might be appropriate, as it is the standard used in most States for adjudicating fraud litigation and could deter some frivolous affirmative claims. *See* Restatement (Third) of Torts: Liab. for Econ. Harm section 9 TD No 2 (2014) (''The elements of a tort claim ordinarily must be proven by a preponderance of the evidence, but most courts have required clear and convincing evidence to establish some or all of the elements of fraud.'')

The Department is interested in comments regarding the benefits or risks of these proposals. The Department also seeks public comments regarding other mechanisms that could be utilized to discourage the submission of frivolous claims, which are costly for the Department and institutions to adjudicate. Such mechanisms could include limiting the period of time after a borrower leaves an institution during which a defense to repayment claim can be submitted (such as imposing a 3 year limit on borrower defense to repayment claims to align with the Department's 3 year record retention requirement).

Under this proposed regulation, the Department would develop a claim review process for either (or both) defensive or affirmative claims that would provide institutions with a reasonable opportunity to see and

respond to borrower claims. The Department proposes, for example, to require the borrower to sign a waiver that allows the institution to provide the Department with any information from the borrower's education records that is relevant to the claim. The Department also proposes to require borrowers to submit information about whether, for reasons other than the education received, the borrower has been removed from a job due to on-the-job-performance, disqualified from work in the field for which the borrower trained, or worked less than full-time in the chosen field. Such circumstances would not disqualify a borrower from a successful defense to repayment, but might be relevant to determining whether the asserted financial harm was in fact caused by an alleged misrepresentation.

The proposed regulations also would remind borrowers submitting affirmative or defensive claims that if the borrower receives a 100 percent discharge for the loan, the institution has the right to withhold an official transcript for the borrower, as has always been the case in instances in which the borrower has been awarded student loan discharge through false certification, closed school or defense to repayment discharge.

The Department also welcomes comments regarding the process the Department might use to collect evidence from borrowers and schools, to evaluate the merits of a borrower's defense to repayment claim, and to render decisions on claims that are submitted affirmatively.

Under proposed § 685.206(d)(4), a borrower defense to repayment related to a loan that was repaid by a Direct Consolidation Loan disbursed on or after July 1, 2019, would be evaluated under the proposed Federal standard. Although this approach may result in different treatment of some borrowers who took out loans before this NPRM, such differences in treatment would arise only if the borrower chose to take out a new Direct Consolidation Loan after July 1, 2019. This is consistent with the longstanding treatment of consolidation loans as new loans. The Department is interested in comments as to whether this structure would likely lead borrowers to engage in, or borrower advocates to encourage, strategic default for the sole purpose of asserting a defense to repayment. Proposed § 685.206(d)(5) includes two alternatives relating to affirmative and defensive claims.

Section 685.206(d)(5)(i) and (ii)—Alternative A provides that the Secretary will approve the borrower's defense to repayment claim if a preponderance of the evidence establishes that the school at which the borrower was enrolled made a misrepresentation, upon which the borrower reasonably relied under the circumstances in deciding to obtain a Direct Loan (or a loan repaid by a Direct Consolidation Loan) for the student to enroll in a program at the school which resulted in financial harm to the borrower. The proposed regulations in § 685.206(d)(5) would define misrepresentation as a statement, act, or omission by the eligible institution to the borrower that is (i) false, misleading, or deceptive, (ii) made with knowledge of its false, misleading, or deceptive nature or with a reckless disregard for the truth, and (iii) directly and clearly related to the making of a Direct Loan for enrollment at the school or to the provision of educational services for which the loan was made. Proposed section 685.206(d)(5)(i) and (ii)—Alternative B contains the same language with respect to defensive claims and extends the proposed standard to affirmative claims.

Proposed § 685.206(d)(5)(iii) sets forth that the Secretary may consider additional information when evaluating a claim. Proposed § 685.206(d)(5)(iv) would provide additional information about what may constitute a preponderance of the evidence of a misrepresentation and evidence of financial harm. The Department is interested in comments as to whether it should require clear and convincing evidence of misrepresentation and financial harm (as opposed to a preponderance of the evidence of misrepresentation and financial harm) in the event it continues to consider affirmative claims.

Proposed § 685.206(d)(6) would clarify that a school's violation of an eligibility or compliance requirement in the HEA or the Department's implementing regulations is not a basis for a borrower defense to repayment unless that conduct would, by itself, establish a basis for a defense to repayment. Proposed § 685.206(d)(6) also lists other circumstances that would not suffice to establish a defense to repayment under the proposed Federal standard.

Reasons: During the public hearings and negotiated rulemaking sessions, the Department heard from representatives from a broad range of constituencies on what they thought was an appropriate basis for a borrower defense to repayment. At the negotiated rulemaking sessions, negotiators expressed a shared desire to develop a regulation that would provide for fair treatment of borrowers who had been harmed by an act or omission of a school, but differed widely in their views of how this might be achieved. The Department began negotiations by asking whether we should establish a Federal standard for evaluating future borrower defense to repayment applications.

Defense to Repayment—Assertion of Borrower Defenses

As part of the discussions of a Federal standard, negotiators debated whether borrowers should be allowed to assert defenses to repayment affirmatively—in other words, at any point of time regardless of whether the borrower's loan is in default and the subject of Department collection proceedings—or only defensively, during such collection proceedings. Many negotiators were in favor of permitting borrowers to pursue affirmative claims to allow borrowers an opportunity to rectify the harm stemming from an act or omission of a school. One negotiator noted that the current regulation implies that a borrower raises a defense to repayment in response to collection activities and asked what, if any, discretion the Department might have to interpret the regulation more broadly. Another negotiator asserted that she understood that the Department did not interpret the current regulation to limit claims to borrowers who are in default and that it had allowed affirmative applications to be submitted by borrowers.

From 1994 to 2015, the Department's regulation—as per earlier negotiated rulemaking—provided defense to repayment loan discharge opportunities only to borrowers who were in a collection proceedings. As a matter of practice, starting in 2015 and later codified in the 2016 regulations, the Department has (primarily in response to the closure of Corinthian Colleges, Inc.) accepted borrower defenses to repayment requests asserted affirmatively outside of the collection proceedings specifically listed in the existing regulation.

We are now considering that for loans first disbursed on or after July 1, 2019, the Department return to the pre-2015 interpretation such that borrowers may only submit applications in connection with one of the specific collection proceedings listed in current § 685.206(c). The language of both the statute and existing regulations on borrower defenses is consistent with this approach, and the Department believes it may better balance the competing interests of borrowers and taxpayers. Under this approach, the Department would view the assertion of

defenses to repayment as a last resort for borrowers, with disputes between borrowers and schools primarily resolved by those parties in the first instance. The proposal to allow borrowers to assert defenses to repayment during the enumerated Department collection proceedings, and not as affirmative claims at any point in time, aligns with the Department's 20 year prior practice and protects taxpayers from liabilities that should be leveraged first against the institutions that committed acts or omissions covered by the defense to repayment provision.

Section 455(h) of the HEA provides that ''a borrower may assert . . . a *defense* to repayment of a loan made under [the Direct Loan Program],'' on the basis of an act or omission of a school, as specified by the Secretary. 20 U.S.C. 1087e(h) (emphasis added). The current regulations implementing the statutory provision reflect the Department's understanding at the time of the rule's promulgation in 1994 that the statute directs the Department to provide borrowers with a *defense* to repayment, as part of certain Department collection actions. *See* 34 CFR 685.206(c)(1) (''In any proceeding to collect on a Direct Loan, the borrower may assert [ ] a *defense* to repayment . . . These proceedings include, but are not limited to, the following . . .'' (emphasis added)). The proceedings referenced in the regulation only occur after a borrower defaults on a loan.

The Department processed a small number of defense to repayment claims from borrowers in a collections proceeding under the existing regulation from 1994 through 2015. In response to the closure of Corinthian Colleges, Inc. (CCI) in 2015, however, the Department changed its position and began to accept borrowers' requests for the type of relief (loan discharges and certain further relief) provided under 34 CFR 685.206(c), even before the borrower defaulted on a loan—or, in other words, the Department allowed borrowers to affirmatively assert borrower defense claims. As a result, the Department was flooded with tens of thousands of borrower defense claims before it had promulgated new regulations that officially notified the public of this new interpretation or established a mechanism or structure under which to adjudicate the large volume of claims.

After further consideration of the history and regulatory provisions governing borrower defenses, the Department believes that it may be appropriate to provide in the proposed regulations that, for loans first disbursed after the proposed rules' anticipated effective date of July 1, 2019, borrowers may request a loan discharge and related relief under the proposed Federal misrepresentation standard for such requests only by asserting such defense in a proceeding to collect on the loan by the Department (*i.e.,* a tax refund offset proceeding, a wage garnishment proceeding, a salary offset proceeding for a Federal employee, or a consumer reporting agency reporting proceeding).

As noted above, this proposal is squarely within the Department's authority under section 455(h) of the HEA to ''specify in regulations which acts or omissions of an institution of higher education a borrower may assert as a *defense* to repayment'' of a Direct Loan. 20 U.S.C. 1087e(h) (emphasis added). It is also consistent with the Department's direction that students should use processes already in place at schools, as well as at accrediting agencies and State authorizing agencies, to resolve issues relating to the services provided by the institution as quickly as possible following any incident, rather than delaying corrective action and shifting the financial burden to the taxpayer.

This differs from the approach taken in the 2016 final regulations. In those regulations, the Department took the approach it had adopted in 2015 to allow affirmative defense to repayment claims and accordingly would have removed language referencing the Department's collection proceedings as the forum for a borrower's assertion of a defense to repayment. The Department continues to consider whether to accept affirmative claims from borrowers, as opposed to only accepting defensive claims from borrowers during a specified collection proceeding. However, the Department believes that if it were to allow affirmative claims, it would need to also consider appropriate deterrents to frivolous claims.

The Department is concerned that in the event of affirmative claims, it is relatively easy for a borrower to submit an application for loan relief, even if the borrower has suffered no harm, on the chance that perhaps some amount of loan forgiveness will be awarded. Although the barriers to submitting a claim are low for borrowers, the collective burden of numerous unjustified claims could be significant for both the Department and institutions. This could delay our efforts to review and provide loan relief to borrowers who have been genuinely harmed. The Department seeks comment on how it could continue to accept and review affirmative claims, but at the same time discourage borrowers from submitting unjustified claims. One idea is to increase the evidentiary standard to ''clear and convincing'' for affirmative claims. The Department seeks comment on whether or not this evidentiary standard would be appropriate to balance the need to serve borrowers who have been harmed and the need to reduce the number of unjustified claims students might otherwise submit. If such a standard is warranted, the Department also seeks comment about whether it should continue to evaluate defensive claims under the preponderance of the evidence standard and on the rationale for having two different evidentiary standards.

The Department believes that, even if it continues to accept affirmative claims, it must also accept defensive claims so both students in repayment and students in collections have access to remedies for instances of fraud.

Defense to Repayment—Federal Standard (Provision of Educational Services and Relationship With the Loan)

The language we propose in this NPRM clarifies that the misrepresentation of a school forming the basis of a borrower defense to repayment discharge must directly and clearly relate to the making of a Direct Loan for enrollment at the school or the provision of educational services for which the loan was made. This language reflects the Department's consistent position, as explained in a Notice of Interpretation issued in 1995 (60 FR 37769) and adopted in the 2016 final regulations (81 FR 76080 (revised 34 CFR 685.206(c)(1)), 76083 (new 34 CFR 685.222(a)(5))), that the Department will acknowledge a borrower defense to repayment only if it directly relates to the loan or to the school's provision of educational services for which the loan was provided.

Some non-Federal negotiators requested that the regulation define the term ''provision of educational services'' and include a reference to educational resources. Another non-Federal negotiator noted that the Department has made its understanding of this term ''provision of educational services'' clear in the regulatory history for the borrower defense regulation and that there are well-developed bodies of State law that explain this term.

The Department agrees that the term ''provision of educational services'' is open to interpretation and, in proposed § 685.206(d), we define that term as ''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.'' We thus intend for a misrepresentation relating to the ''provision of educational services'' to be clearly and directly related to the borrower's program of study. We also intend misrepresentation to include items such as the nature of the school's educational program or related resources required by an accreditor or licensing authority, the nature of the school's financial charges, the advertised outcomes (including job placement rates, licensure pass rates, and graduation rates) of prior graduates of the school's educational program, an institution's published rankings or selectivity statistics, the eligibility of graduates of the educational program for licensure or certification, the State agency authorization or approval of the school or educational program, or an accreditor approval of the school or educational program.

Defense to Repayment—Consolidation Loans

The Department proposes that for a Direct Consolidation Loan first issued on or after the anticipated effective date of these regulations, a borrower may assert a defense to repayment under the proposed Federal standard (discussed below). Under the Department's existing regulation at 34 CFR 685.220, a borrower may consolidate certain specified loans into a Direct Consolidation Loan. Generally, the Department views a consolidation loan as a new loan, distinct from the underlying loans that were paid in full by the proceeds of the Direct Consolidation Loan. The Department's borrower defense authority is part of the Direct Loan Program, *see* 20 U.S.C. 1087e(h) (''[A] borrower may assert . . . a defense to repayment of a loan made under this part [as to the Direct Loan Program]'') and Direct Consolidation Loans are made under the Direct Loan Program. As a result, the Department's existing practice is to provide relief under the Direct Loan authority if the underlying loans have been consolidated under the Direct Loan Program into a Direct Consolidation Loan. Or, if consolidation is being considered depending on the outcome of any preliminary analysis of whether relief might be available under 34 CFR 685.206(c), relief is not actually provided until the borrower's loans have been consolidated into a Direct Consolidation Loan.

The Department's proposal clarifies the Department's position and the standard that it proposes to use to evaluate a Direct Consolidation Loan borrower's defense to repayment claim. The Department will consider a misrepresentation that the borrower reasonably relied upon under the circumstances in deciding to obtain the underlying loan repaid by the Direct Consolidation Loan, for the student to enroll or continue enrollment in a program at an institution.

The Department's standard is designed to provide borrowers with relief for the misrepresentations made with either knowledge of their false, misleading, or deceptive nature, or with a reckless disregard for the truth. Where misconduct of such nature has been demonstrated, the Department believes it is appropriate to provide borrowers with relief, regardless of whether the underlying loan is a Direct Loan. However, given that the Department's borrower defense authority is part of the Direct Loan Program, *see* 20 U.S.C. 1087e(h) (''[A] borrower may assert . . . a defense to repayment of a loan made under this part [as to the Direct Loan Program]''), the Department will only consider providing such relief if the underlying loans were themselves Direct Loans or have been consolidated under the Direct Loan Program, into a Direct Consolidation Loan. If a defense to repayment was approved on a Direct Consolidation Loan, borrowers would receive a discharge of the remaining balance on their Direct Consolidation Loan in an amount proportionate to the amount of the underlying loan at issue and would receive proportionate reimbursements of any payments made to the Secretary on the underlying loan or the Direct Consolidation Loan. *See Hiatt* v. *Indiana State Student Assistance Comm. (In re Hiatt),* 36 F.3d. 21, 24 (7th Cir., 1994) and *In re McBurney,* 357 B.R. 536, 538 (9th Cir BAP, 2006), supporting the consideration of consolidation loans as new loans.

Under the Department's proposal, the standard that would be applied to determine if a defense to repayment has been established is the Federal standard for Direct Consolidation Loans first disbursed after July 1, 2019. The 2016 final regulations would have similarly applied a Federal standard to some underlying loans that were *not* Direct Loans, but it would have done so based upon the underlying loans' date of first disbursement. Thus, under the 2016 final regulations, the same claim might have required the application of different standards to different underlying loans, if the borrower had both underlying Direct Loans and loans that are not Direct Loans. The Department believes that the language it proposes in this NPRM is more consistent with the Department's longstanding policy regarding the treatment of consolidated loans, would be more easily understood, would create less confusion for schools and borrowers, and would be easier to administer for the Department. Further, as a consolidation loan is a new loan, the Department believes it is appropriate to apply the date of first disbursement of that loan to determine what standard would apply. The Department understands that this approach may deter some borrowers who might otherwise wish to consolidate their loans but do not wish to be subject to the proposed standard and associated time limits. But the Department believes that this concern is outweighed by the benefits of this standard. In all events, as under the existing regulations, a borrower would be able to choose consolidation if he or she determines it is the right option for the borrower. The Department invites comment on this approach.

Defense to Repayment—Federal Standard (Misrepresentation)

In this rulemaking, the Department is proposing an exclusively Federal standard not based in State law for loans disbursed after July 1, 2019, for ease of administration and to provide fair, equitable treatment for all borrowers regardless of the State in which the school is located or the student was in residence while enrolled or while in repayment. That Federal standard differs somewhat from the ''substantial misrepresentation'' standard adopted in the 2016 final regulations and drawn from more general enforcement contexts. 81 FR 75939–75940. It also differs somewhat from the proposal that the Department offered during negotiations, in that it relies solely on misrepresentation as the basis for discharge, rather than also allowing final judgments to serve as a basis for discharge. As discussed in more detail below, the Department believes that the standard it proposes will provide more equitable treatment for borrowers and ease of administration for the Department.

During discussions relating to the Federal standard for borrower defense to repayment applications, negotiators disagreed about whether to establish a Federal standard at all. Some negotiators expressed opposition, arguing that protecting consumers and ensuring the educational quality of schools licensed to operate by the State are the responsibilities of the States. Other negotiators noted that a Federal standard not based in State law could disadvantage borrowers. Many States'

consumer protection laws might be more favorable to borrowers than the Federal standard proposed by the Department (discussed immediately below). These negotiators also noted that the proposed Departmental process to adjudicate claims under a Federal standard would not provide borrowers with the benefit of a discovery process like the one that exists in judicial proceedings. Still, many negotiators supported establishing a Federal standard, arguing that doing so would provide clarity, uniformity of borrower treatment, and ease of administration. Some negotiators stated that the Department should adopt a structure under which a Federal standard would serve as a minimum standard, but with the Department also evaluating whether a borrower defense claim would receive more favorable treatment under applicable State law and then applying the more favorable standard to the borrower defense claim.

The Department is persuaded that an exclusively Federal standard for borrower defense to repayment applications is appropriate. The Department's primary reason for proposing a Federal standard for borrower defenses to repayment is that Direct Loans are Federal assets and the benefits of such loans should be established by Federal law. In addition, the Department believes that using a Federal standard will reduce the burden on borrowers and the Department. Applying a State law-based standard means that borrowers have to determine which State law applies to their claim and the Department has to review that determination. Moreover, borrowers in some States may have access to more favorable law than borrowers in other States for the same Federal defense to repayment. In contrast, applying a Federal standard will eliminate the issue of what law applies and ensure that all borrowers' claims are evaluated under the same rules.

The Department's proposed Federal standard is a modified version of the proposal it offered at the negotiated rulemaking sessions. The Department's proposal during negotiations would have included two different bases for a borrower to assert a defense to repayment for loans first disbursed on or after July 1, 2019: (1) A final, definitive judgment by a State or Federal court of competent jurisdiction, rendered in a contested proceeding, where the borrower was awarded monetary damages against the institution relating to the student's enrollment at the subject institution or the provision of educational services for which the loan was obtained, and (2) generally, a misrepresentation by the school made with intent to deceive, knowledge of the falsity of the misrepresentation, or a reckless disregard for the truth, and that resulted in financial harm to the borrower. In this NPRM, the Department now proposes a modified version of the second basis for relief—a misrepresentation standard, as discussed in depth below.

With regard to the misrepresentation standard, negotiators disagreed on the appropriate definition of ''misrepresentation'' and whether the borrower should be required to prove the school's intent, knowledge of falsity, or reckless disregard for the truth. Some negotiators argued that it would be difficult for a borrower to prove that a school had acted with the requisite intent or had knowledge of the falsity of the misrepresentation, and that it would also be difficult for a borrower to demonstrate that the school had engaged in a level of misconduct that would amount to a ''reckless disregard for the truth.'' These negotiators argued in favor of a standard that would enable borrowers to avail themselves of the full range of States' consumer protection laws that prohibit certain unfair and deceptive conduct (commonly known as ''unfair and deceptive trade acts and practices'' or ''UDAP'' laws). Some negotiators argued the Department should not approve borrower defenses and also hold a school liable for losses from approvals of misrepresentation-based defenses to repayment, if the school had committed an inadvertent mistake or if the misrepresentation had been made by an employee acting without the school's knowledge or against the school's direction.

The 2016 final regulations provided that a borrower may assert a borrower defense for a ''substantial misrepresentation'' as defined in the Department's regulation at 34 CFR 668.71, if the school, any of its representatives, or any institution, organization, or person with whom the school has an agreement for specified services made such a substantial misrepresentation that the borrower reasonably relied on to the borrower's detriment in deciding to attend, or continue attending, the school or in deciding to take out a Direct Loan. *See* 81 FR 76083 (text for 34 CFR 685.222(d)). The 2016 final regulations also included a non-exclusive list of circumstances for a Department official to consider in determining whether the borrower's reliance was reasonable. Under those regulations, a borrower would be able to assert such a borrower defense to recover funds previously collected by the Secretary not later than six years after the borrower discovered, or reasonably could have discovered, the substantial misrepresentation. The borrower would also be able to assert a defense to any outstanding amounts owed on the loan at any time.

The ''substantial misrepresentation'' definition was drawn from § 668.71, which permits the Department to bring an enforcement action for a substantial misrepresentation in the form of a suspension, limitation, termination, or fine action. The section generally defines a misrepresentation as any false, erroneous, or misleading statement made by a school, and it defines a misleading statement to include any orally or visually made statement, or one that is made in writing or by other means, that has the likelihood or tendency to deceive. It then defines a ''substantial misrepresentation'' as any misrepresentation on which the person to whom it was made could reasonably be expected to rely, or has relied, to that person's detriment. The 2016 final regulations amended the language of § 668.71 to explicitly note that an omission of information can amount to a misrepresentation. 81 FR 76072 (text of language added to 34 CFR 668.71). As stated above, while a substantial misrepresentation under current § 668.71 includes misrepresentations that a person had relied upon or could reasonably have been expected to rely upon, for the purposes of borrower defense to repayment under the 2016 final regulations, a substantial misrepresentation would have been found only if the person had, indeed, reasonably relied upon the misrepresentation to his or her detriment.

In this NPRM, the Department proposes a different Federal standard for defenses to repayment based upon misrepresentations by an institution to the borrower. Under the proposed standard, a misrepresentation is 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 enrollment at the school or to the provision of educational services for which the loan was made. The vast majority of the borrower defense claims filed since 2015 have alleged that the school at issue made statements to the borrower that amount to misrepresentations under State law. As

a result, we believe it is appropriate to base the Federal standard upon a school's misrepresentations. We have removed breach of contract or State law judgment as a standard for borrower defense relief since breach of contract or a State law judgment may be for actions or events not directly related to the educational services provided by the institution, and therefore do not qualify for relief under borrower defense to repayment. That said, a State law judgment could serve as evidence provided by a borrower in filing a borrower defense to repayment application.

Nothing in this proposed regulation attempts to prevent a borrower from taking action against an institution of higher education based on State law. However, for the purpose of evaluating a borrower's defense to repayment claim, only the new Federal standard will be considered.

The proposed standard takes the same position as in the 2016 final regulations that certain persons and institutions affiliated with a school may make misrepresentations leading to a borrower defense to repayment under circumstances generally understood to render those misrepresentations attributable to the school.

In the 2016 final regulations, the Department declined to include a requirement that the borrower prove that the school had acted with intent in making the misrepresentation. In the preamble to those regulations, the Department also specifically declined to include any requirement that the Department find that the school had knowledge of the misrepresentation. 81 FR 75947. The Department reasoned, in 2016, that it is more reasonable and fair to have an institution be responsible for the harm caused to borrowers as a result of a misrepresentation, even if such a misrepresentation is the result of innocent or inadvertent mistakes. *Id.* at 75947–75948.

As was the case in the 2016 final regulations, the Department does not propose that a defense to repayment be approved only when a school can be shown to have made a misrepresentation with the intent to induce the reliance of the borrower on the misrepresentation. The Department agrees with negotiators that it is unlikely that a borrower would have evidence to demonstrate that an institution had acted with intent to deceive. But given its responsibility to the Federal taxpayer, the Department believes that defense to repayment should be granted only where a preponderance of the evidence shows that a school has made a misrepresentation with either knowledge of its falsity or with a reckless disregard of the truth. The Department's proposal includes a non-exhaustive list of evidence that may indicate that such a misrepresentation took place. The Department believes that this standard strikes a balance between protecting borrowers by establishing a standard of evidence that is reasonable for a borrower to meet and protecting the Federal taxpayer by requiring a level of evidence that ensures misrepresentation actually took place and the student relied upon that misrepresentation and suffered harm.

Like the 2016 final regulations, the Department's proposed misrepresentation standard also covers omissions. The Department believes that an omission of information that makes a statement false, misleading, or deceptive can cause injury to borrowers and can serve as the basis for a defense to repayment. As it did in the 2016 final regulations, the Department recognizes that the reasonableness of a borrower's reliance on the misrepresentation may depend upon the circumstances, and its proposed rule thus states that the Department will look at whether a borrower reasonably relied upon the misrepresentation ''under the circumstances.''

Under the proposed alternative regulations, which would return to the practice of allowing borrower defense to repayment applications only in response to Department collection proceedings, the proposed standard differs from the time limitations imposed under the 2016 final regulations. Those regulations imposed a six-year limitation period on a borrower's ability to raise a defense to repayment claim for amounts previously collected. Under the proposed standard, a borrower may be able to assert a defense to repayment at any time during the repayment period, once the loan is in collections, regardless of whether the collection proceeding is one year or many years after a borrower's discovery of the misrepresentation. The proposal does not impose a limit on the borrower's ability to recover amounts previously collected by the Department.

The Department considered an alternative approach in which the borrower would have only three years following the end of enrollment at the institution to assert a defense to repayment claim. This three-year limit corresponds to the three-year record retention policy imposed by the Department. It is unlikely that it would take a borrower more than three years to realize that he or she was harmed by misrepresentations upon which the borrower relied to make an enrollment decision. However, since collection proceedings can be initiated at any time during the repayment period, the current proposal similarly provides borrowers with the opportunity to assert a defense to repayment during a collection proceeding, regardless of how many years after enrollment that proceeding is commenced. In the event that the Department is persuaded by public comments provided in response to this NPRM to continue accepting affirmative claims, the Department proposes to implement a three-year limit on filing claims after the end of the borrower's enrollment at the institution accused of misrepresentation.

The proposed standard also differs from the 2016 final regulations in that it does not include breach of contract or a State law judgment as a standard for defense to repayment. Although those standards are utilized by the Department in enforcement actions, and breach of contract or a State law judgment could be used as evidence to substantiate a borrower defense claim, breach of contract or a State law judgment, alone, does not automatically qualify a borrower for borrower defense to repayment relief since these may pertain to actions or activities other than the institution's provision of educational services.

Some negotiators noted that consumer protection laws governing misrepresentations are generally the province of the States, but the Department's proposed Federal standard would not invade that province. The proposed Federal standard would not prevent a borrower from pursuing a claim against a school based on a violation of State law. It simply would not provide for that claim to be the basis of a borrower defense to repayment claim. Thus, it would leave such State law claims to be pursued through arbitration, State courts, or other administrative bodies responsible for adjudicating them.

Other negotiators expressed concern that changes to a financial aid award letter not be construed as misrepresentations, and the Department agrees that such changes ordinarily would not qualify as misrepresentations. For example, if a financial aid award letter changes as a result of a change in the borrower's financial circumstances, the Department would not consider the change to form the basis of a borrower defense to repayment claim under our proposed regulations.

Borrower Defense—Judgments and Breach of Contract

During the negotiations, the Department discussed using a non-default, contested Federal or State court judgment issued by a court of competent jurisdiction, as a possible basis for borrower defense claims. Negotiators expressed support generally for a judgment-based standard as one basis for a claim, but some negotiators expressed concern that lawsuits based on the acts or omissions of a school have often been concluded by default judgments that did not result from a contested proceeding or by settlement. Some negotiators also expressed the concern that borrowers may not have the resources to bring such lawsuits or that the schools may require borrowers to execute agreements that would prevent such lawsuits. They urged that the Department accept judgments obtained by government entities, such as State Attorneys General. However, since Direct Loans are Federal assets, only the Federal government has the authority to relieve a borrower of his or her repayment obligation. Therefore, although a State law judgment could serve as evidence to support a borrower defense to repayment claim, the judgment alone would not be sufficient to grant automatic relief.

The Department had included non-default, favorable contested judgments as a basis for a borrower defense claim for loans first disbursed after the anticipated effective date of the 2016 final regulations. In the preamble to those regulations, the Department stated that while it does not anticipate such judgments to be common, such a standard would allow the Department to continue to recognize State law causes of action, without putting the burden on the Department to interpret and apply States' laws. 81 FR 75941–75942. However, this does not alleviate the inequities that can result if, as a result of differences in State laws, two borrowers who have suffered equal harm as the result of the same misrepresentation receive different treatment. Therefore, in this regulation we propose a single Federal standard that would ensure equal treatment of borrowers regardless of where they live or their school is located.

The Department acknowledges negotiators' concerns that some court cases do not result in contested, non-default judgments, such as where the institution chooses to settle pending litigation or an arbitration proceeding and satisfies the claim pursuant to a settlement agreement or consent judgment, or where an insurer for the institution satisfies the claim. But the Department believes this concern is less pressing for these regulations, which do not propose a judgment-based standard for a defense to repayment claims. The Department also acknowledges that private parties often settle disputes among themselves without court action. The Department believes that it is preferable for a school (or its insurer, if such coverage exists) to satisfy a student borrower's meritorious claims of misrepresentation against it and to provide appropriate relief directly to the student borrower for the school's own actions where it is merited. A borrower who receives a favorable decision in such a dispute but believes he or she still has not received the relief to which he or she is entitled may submit the record of that dispute process and decision as evidence in support of the defense to repayment claim with the Department. As part of its adjudication of a defense to repayment, and if the evidence is directly and clearly related to the loan or to the school's provision of education services for which the loan was provided, the Department may also consider as evidence findings of fact by a court of competent jurisdiction or arbitrator, admissions of fact by the school made in a court of competent jurisdiction or arbitration, and court orders.

During the negotiated rulemaking sessions, one negotiator proposed including breaches of contract as a basis for borrower defense claims. In 2016, the Department included breach of contract as a basis for borrower defense in recognition of lawsuits borrowers have brought alleging breaches of contract. 81 FR 39341. But the majority of the defense to repayment applications before the Secretary do not allege breaches of contract, and the Department believes it is appropriate in these proposed regulations to tailor the standard to the types of claims being alleged by borrowers. Moreover, breach of contract, as described in the 2016 regulations, would cover conduct beyond the scope of defense to repayment since breach of contract is not limited to the provision of education services. If the conduct underlying a breach of contract would satisfy the proposed requirements for a misrepresentation, a borrower may assert a defense to repayment for that misrepresentation during a collection proceeding. Or, prior to those proceedings, a borrower may pursue more expedient relief through a school's internal dispute process, arbitration, or other legal proceeding.

While the Department is proposing a new Federal standard based in misrepresentation for loans first disbursed on or after the anticipated effective date of the proposed regulations, July 1, 2019, we are not proposing any changes to the existing State law standard (or, as noted above, the context in which a defense to repayment may be requested) for loans first disbursed before the anticipated effective date of these regulations. Rather, for loans made on or before July 1, 2019, the Department proposes to keep the State law-based standard in the currently effective regulations. In the event that a borrower enters into a consolidation loan, the date on which the loan was consolidated (prior to or after July 1, 2019) determines whether the Department will review a defense to repayment claim based on a State law standard or the proposed Federal standard.

Borrower Defense—Evidentiary Standard for Asserting a Borrower Defense

During the negotiated rulemaking sessions, negotiators were divided on the evidentiary standard that should be applied to borrower defense to repayment claims adjudicated by the Department under a Federal standard. There were extensive discussions regarding the meaning of, and differences between, the terms ''clear and convincing evidence'' and ''preponderance of the evidence.'' Some negotiators argued that the evidentiary standard should use terms that are consistent with legal terminology and precedent. Other negotiators advocated using an evidentiary standard that is not based on legal terminology and might be clearer to individual borrowers. In addition, several negotiators argued in favor of an evidentiary standard based on ''clear and convincing evidence;'' others argued that a ''preponderance of the evidence'' standard would be fairer to borrowers, since it would not require a high level of evidence that borrowers would be unlikely to be able to provide. One negotiator noted that preponderance of the evidence is the typical standard that applies in civil cases. Negotiators representing consumer advocates asserted that the Department's proposal to apply a preponderance of the evidence standard that requires corroboration of the borrower's attestation would be harder to satisfy than a simpler preponderance of the evidence standard.

We preliminarily agree with negotiators that, given the types of evidence borrowers are likely to have in their possession, a preponderance of the evidence standard is appropriate. The Department is accordingly proposing an

evidentiary standard that requires the borrower to establish by a preponderance of the evidence that the school at which the borrower enrolled made a statement, act, or omission directly and clearly related to enrollment at the school or the provision of educational services upon which the borrower reasonably relied under the circumstances in deciding to obtain a Direct Loan to enroll or continue enrollment in a program at the school that resulted in financial harm to the borrower.

As we noted in the 2016 final regulations, the Department uses a preponderance of the evidence standard in other proceedings regarding borrower debt issues. See 34 CFR 34.14(b), (c) (administrative wage garnishment); 34 CFR 31.7(e) (Federal salary offset). We believe that this evidentiary standard strikes a balance between ensuring that borrowers who have been harmed are not subject to an overly burdensome evidentiary standard and protecting the Federal government, taxpayers, and institutions from unsubstantiated claims.

Proposed § 685.206(d)(5)(ii)—Alternative A would provide that the Secretary will find that the preponderance of the evidence supports the approval of a borrower defense to repayment discharge when the borrower's attestation is supported by sufficient evidence provided by the borrower or otherwise in the possession of the Secretary. The Secretary will permit the institution to review and respond to this evidence and will consider the school's response. Alternative B for this section would extend this standard to affirmative claims as well.

Borrower Defense—Financial Harm

Consistent with its proposal during the negotiated rulemaking sessions, the Department proposes that a misrepresentation may serve as a basis for a borrower defense to repayment only if the misrepresentation resulted in financial harm to the borrower. During discussions of this issue, some negotiators argued that the act of taking a Federal student loan should be sufficient evidence of financial harm to the borrower. These negotiators suggested that, absent the misrepresentation, the borrower may have opted to not take a Federal student loan.

The Department does not agree that taking a Federal student loan, by itself, is sufficient evidence of financial harm to the borrower in the context of a borrower defense to repayment. Borrowers consider a variety of factors in choosing a school or program, including not just cost, but also other attributes of the school, such as its facilities, convenience, and the opportunity for the student to enroll in his or her program of choice (which may be unavailable to the student at other institutions). The borrower has the opportunity to compare schools' and programs' relative costs and other factors before committing to borrow and repay a Federal student loan, and the borrower has the opportunity to leave an institution should it not provide educational opportunities or experiences commensurate with the borrower's expectations. Therefore, even in the event of misrepresentation, the borrower may not be successful in receiving loan relief under the defense to repayment regulation if that misrepresentation was not the basis for the borrower's enrollment decision or it did not cause subsequent financial harm.

Moreover, the Master Promissory Note signed by the borrower describes the borrower's obligation to repay the full amount of the loan even if the student borrower (or the student for whom a PLUS loan was obtained) does not complete the program, does not complete the program within the regular time for program completion, is unable to obtain employment upon completion, or is otherwise dissatisfied with or does not receive the educational or other services that the student borrower purchased from the school. The foregoing information is provided to borrowers again during entrance counseling.

As discussed earlier, some negotiators were concerned that a borrower might allege misrepresentation on the part of the school based solely on a change in the borrower's financial aid award due to changes in financial circumstances or the availability of outside aid, such as vocational rehabilitation funding. The Department does not view such changes to necessarily be evidence of a misrepresentation on the part of the school. Instead, the proposed regulations specify that financial harm may be established if, for example, there were a significant difference between the actual amount or nature of the tuition and fees charged by the school for which the Direct Loan was obtained and the amount or nature of the tuition and fees that the school represented to the borrower the school would charge or was charging. Similarly, financial harm might be established if an institution awarded sizeable grants or scholarships to attract a student to an institution, but then failed to continue such support throughout the program (except in cases in which the student failed to meet the requirements of the scholarship or grant), because the student could have made the decision to enroll based on the reasonable belief that scholarship or grant support would continue. Such misrepresentation could potentially form the basis of a defense to repayment claim.

Some negotiators advocated including opportunity costs or the quality of education as evidence of financial harm. However, the Department believes these assertions of financial harm are too difficult to quantify to be used for that purpose.

Under the 2016 final regulations, a borrower was required to show that he or she had reasonably relied upon the misrepresentation to his or her detriment. 81 FR 76083 (text of 34 CFR 685.222(d)(1)). The use of the word ''detriment'' echoed the definition for substantial misrepresentation under the Department's regulation for its enforcement activities for a school's misrepresentation under 34 CFR 668.71, which was expressly cross-referenced by the 2016 final regulations' borrower defense to repayment standard. While the 2016 final regulations did not include a definition for ''detriment,'' in the preamble, the Department noted that generally the term refers to any loss, harm, or injury suffered by a person or property. 81 FR 75951. Further, the Department stated that there was no quantum or minimum amount of detriment required for borrower defense under the substantial misrepresentation standard and a school's failure to provide some element or quality of a program that had been promised may be such a detriment. *Id.*

Under the proposed Federal standard, a borrower would be required to demonstrate that the borrower had suffered financial harm as a result of the misrepresentation by the school, and does not use the word ''detriment.'' As the Department is not proposing to align the Department's enforcement regulation at 34 CFR 668.71 for misrepresentation to the borrower defense to repayment standard, we do not believe it is necessary to use the same term in the proposed regulation. Further, in light of the Department's interest in balancing the need to protect both borrowers and Federal taxpayers, the Department believes it is appropriate to require that financial harm, in the form of a monetary loss as a result of the misrepresentation, be present for a borrower defense to repayment to be approved. As with the 2016 final regulations, however, the Department does not believe it is necessary for a borrower to demonstrate

a specific level of financial harm, other than the presence of such harm, to be eligible for relief under the proposed standard.

Borrower Defense—Filing Deadline for Asserting a Borrower Defense Claim

During the negotiated rulemaking sessions, negotiators discussed whether to impose time limits on a borrower's ability to assert a borrower defense to repayment and possible time periods for such limits. Some negotiators expressed concern that the imposition of a limitation period would bar otherwise valid borrower defenses to repayment, even when the loan(s) in question remained collectible under Federal law.

The proposed regulations do not impose a statute of limitations on the filing of a borrower defense to repayment claim. However, a borrower must comply with the filing deadlines established for the different proceedings in which a borrower defense claim may be raised. For example, when the Department intends to garnish a borrower's wages, the borrower is sent a notice of the Department's intention to initiate wage garnishment and is provided 30 days to request a hearing to dispute that action. A borrower could raise a defense to repayment claim during that 30-day timeframe, but would not be able to raise a claim after that period has elapsed.

With our regulatory proposal to accept defense to repayment claims during the enumerated collection proceedings, as opposed to the regulatory proposal to accept both defensive and affirmative claims, we do not propose to incorporate the timeframes for submission of borrower defense to repayment claims that were included in the 2016 final regulations. As discussed previously, the 2016 final regulations established time limits for borrowers' claims regarding recovery of amounts previously collected, but allowed defenses of repayment for amounts owed to be brought at any time. This NPRM instead enables borrowers to assert claims during collection proceedings, which can occur at any time during the repayment period. Borrowers can accordingly raise their defenses whenever such proceedings are instituted, but must comply with the existing filing deadlines for raising defenses in those collections proceedings. The Department proposes adopting the existing filing deadlines for defensive claims both because amending those deadlines was beyond the scope of the negotiated rulemaking and because harmony of deadlines will reduce confusion for borrowers.

The filing deadlines for the various proceedings in which a defensive borrower defense claim may be raised are reflected in the chart below:

Collection action	Number of days[3] for borrower response
Tax Refund Offset proceedings under 34 CFR 30.33	65
Salary Offset proceedings for Federal employees under 34 CFR part 31	65
Wage Garnishment proceedings under section 488A of the HEA	30
Consumer Reporting proceedings under 31 U.S.C. 3711(f)	30

Similar to our approach to timeframes in this NPRM, for suspension of collections, we follow the existing processes in the applicable collection proceeding. For example, with regard to wage garnishment proceedings under section 488A of the HEA, the accompanying regulations at 34 CFR 32.10 state that the wage deductions do not begin until a written decision has been issued, if the borrower has requested a pre-offset hearing to review the existence of amount of the debt. Thus, if a borrower defense claim has been raised in the context of a wage garnishment proceeding, collections would be suspended until a written decision on the wage garnishment has been issued. The 2016 final regulations also included suspension of collection for defaulted loans during a pending borrower defense claim.

If the Department were to accept affirmative claims as well as defensive claims, the Department proposes to impose a three-year time limit on borrowers to file such claims based on regulations that require institutions to retain administrative records for three years, while allowing defensive claims to be asserted at any time in response to collection proceedings. The Department welcomes comments on other approaches to set up a window for submitting affirmative claims. Since institutions would likely need access to records to defend themselves against inaccurate claims, it would make sense to require that affirmative borrower defense claims must be made within the first three years after a student leaves an institution. We recognize that in the case of defensive claims, it is likely that the institution would no longer have access to certain records, but the Department must balance that concern with the need to provide borrowers an opportunity to make a defense to repayment claim during already established opportunities for the borrower to challenge collection of the loan.

[3] The days listed may vary depending on the particular circumstances of each borrower's situation.

Borrower Defense—Exclusions

As discussed above, the Department's consistent position since 1995 has been that the Department will acknowledge a borrower defense to repayment only if it directly relates to the loan or to the school's provision of educational services for which the loan was provided. 60 FR 37769. As a result, the Department has not considered personal injury tort claims or allegations of sexual or racial harassment to be grounds for alleging a defense to repayment. In these regulations, the Department proposes making this limit explicit and provides a non-exhaustive list of circumstances that would not constitute, in and of themselves, borrower defenses to repayment that are directly related to the borrower's loan or the provision of educational services. This list also includes slander or defamation, property damage, and allegations about the general quality of the student's education or the reasonableness of an educator's conduct in providing educational services. The Department believes such a list will provide clarity and guidance for borrowers and schools in applying the proposed defense to repayment regulation.

The proposed regulations further state that a violation of the HEA does not by itself establish a defense to repayment, unless the underlying conduct also meets the Federal standard under the regulations. This has been the Department's consistent position since 1995. *See* 60 FR 37769; 81 FR 76053 (text of 34 CFR 685.222(a)(3) (defense to repayment regulation does not provide a private right of action for a borrower nor create any new Federal right)).

For all of these reasons, we are proposing to adopt the regulations described above and to rescind the Federal standard provisions of the 2016 final regulations.

Borrower Defense Adjudication Process (§§ 685.206, 685.212)

Statute: Section 455(h) of the HEA authorizes the Secretary to specify in regulation which acts or omissions of a school a borrower may assert as a defense to repayment of a Direct Loan.

Current Regulations: Section 685.206(c) provides that borrowers may

assert a borrower defense to repayment during proceedings which are available to the borrower when the Department initiates certain collection actions on a Direct Loan.

Section 685.212 establishes the conditions under which the Department discharges a borrower's obligation to repay a loan, or a portion of a loan, under various discharge or forgiveness provisions of the HEA, including closed school discharges, false certification discharges, and public service loan forgiveness.

Proposed Regulations: Proposed § 685.206(d)(2) and (3) describes the process by which a borrower would file a borrower defense to repayment application for a loan disbursed on or after July 1, 2019. Proposed § 685.206(d)(2) would specify that a borrower may assert a borrower defense to repayment in any of the enumerated proceedings to collect on a Direct Loan. Proposed § 685.206(d)(3) would specify that the borrower must raise a defense to repayment within the specified timeframe included in the notification to the borrower of the Department's action to collect on a defaulted student loan. The borrower would submit a completed borrower defense to repayment application to the Department on a form approved by the Secretary and signed under penalty of perjury. The borrower must also submit any evidence supporting the defense to repayment within the specified timeframe included in the Department's directions to the borrower.

Proposed § 685.206(d)(7) provides that the school against which the borrower alleges misrepresentation in a defense to repayment will be notified of the pending application and allowed to submit a response and evidence within the specified timeframe included in the notice.

Proposed § 685.206(d)(8) provides the items the Secretary may consider in resolving a borrower defense to repayment claim and that, following such consideration, the Secretary will issue a written decision informing both the borrower and the school of the relief, if any, that the borrower will receive.

Proposed § 685.206(d)(9) would provide that the Secretary would decide the amount of financial relief provided to the borrower upon the determination of successful borrower defense to repayment. This section also would provide that the amount of relief awarded to a borrower during the borrower defense process would be reduced by any amounts that the borrower obtained from the school or other sources for claims related to the justification of the defense to repayment, as reported pursuant to proposed § 685.206(d)(3).

Proposed § 685.206(d)(10) provides that the determination of a borrower defense by the Department is final and not subject to appeal.

Proposed § 685.212(k)(1) would add borrower defense discharges to the discharge provisions listed in § 685.212.

Reasons: During negotiated rulemaking, some negotiators were in favor of the Department providing borrowers with a non-adversarial process through which to seek resolution, with others asserting that in such a process, the Department should rely primarily on the borrower's attestation, submitted under penalty of perjury, and that corroborating evidence could come from the Department's own records. Other negotiators advocated for a more extensive process for resolving borrower defenses to repayment, and asserted that an unsubstantiated assertion of wrongdoing by a borrower should not be sufficient to justify the discharge of a borrower's Federal student loans or to impose a financial liability upon the school for the relief provided to the borrower.

The 2016 final regulations established separate adjudication processes for borrower defense to repayment applications submitted by individuals and those to be considered as a group. Generally, for the individual application process, the 2016 final regulations established that a borrower would submit an application on a form approved by the Secretary and provide any supporting evidence or other information or documentation reasonably requested by the Secretary. A Department official would then take appropriate action to put the borrower in loan forbearance, if not declined by the borrower, or, in the case of a defaulted loan, in stopped collection status. Next, the Department official would conduct a fact-finding process, during which the Department would notify the school of the defense to repayment application and consider the application and any supporting evidence provided by the borrower. According to the 2016 regulations, the Department official would consider any additional information found in the Department's records, or obtained by the Department. If requested by the borrower, the Department would identify relevant records to the borrower and provide such records upon reasonable request. At the end of the process, the Department official would issue a written decision. Although the written decision would be the final decision of the Department, the borrower could request reconsideration, upon the identification of ''new evidence,'' or relevant evidence not previously provided by the borrower or identified in the written decision. 81 FR 76083–76084 (text of 34 CFR 685.222(e)).

The process proposed by the Secretary in this NPRM would require that the borrower submit an application to the Department along with any supporting evidence. Whereas the 2016 final regulations did not explicitly provide an opportunity for schools to submit evidence and information in response to the borrower defense claim, this NPRM proposes to provide schools with an opportunity to provide a response and supporting evidence. Given the fact-specific nature of misrepresentation claims, the Department believes that it is appropriate to obtain as much evidence as possible from all sources, including from the school alleged to have made the misrepresentation. The Department would not, however, rely upon Department records or other information obtained by the Secretary, unless the school had an opportunity to review and respond to such evidence. The Department believes that the proposed process will assist it in making fair and accurate decisions, while providing borrowers and schools with due process protections.

As discussed in the section titled ''Defense to Repayment—Federal Standard for Asserting a Defense to Repayment,'' the Department is proposing that borrowers who have defaulted on a Direct Loan may raise a defense to repayment of loans first disbursed on or after July 1, 2019, on the basis of the proposed Federal misrepresentation standard, in response to a notice of the Department's intent to engage in certain collection actions. The Department's existing regulations as to those collection actions provide certain processes and protections for borrowers, which the Department is not proposing to change and would apply to borrower defense to repayment applications made during the course of those proceedings.

As is the case for defense to repayment claims under the existing regulation and the 2016 final regulations, the Department proposes that a decision made in the adjudication process be final as to the merits of the defense to repayment and any relief to be provided as a result. In this way, borrowers will not be subject to the additional wait that an appeal period may cause and will receive more expedient relief. We address the issue of reconsideration later in this section.

In the 2016 final regulations, the Department established a process for evaluating defense to repayment applications, regardless of the substantive standard that would be applied to the defense to repayment. Because the Department is now proposing that, for loans first disbursed on or after the anticipated effective date of these regulations (July 1, 2019), defenses to repayment applications be made only during the specified collection proceedings. The Department will continue to apply the State law standard for loans made prior to July 1, 2019. The Department proposes only clarifying updates to the statutory and regulatory cross-references for the collection proceedings listed for defenses to repayment for pre-effective date loans, and otherwise retains the existing language of current 34 CFR 685.206(c) as to such defenses to repayment applications. We also propose to rescind the process for adjudication of borrower defense to repayment portions of the 2016 final regulations.

The Department seeks public comment regarding potential processes that could be used to adjudicate affirmative claims, should the Department accept affirmative claims for some period after a borrower ends enrollment at an institution. The Department preliminarily believes that such a process must include an opportunity for the institution to receive a copy of the borrower's claim and a signed waiver allowing the institution to share relevant portions of the borrower's education record with the Department, and provide sufficient time for the institution to provide a response and any supporting evidence of its own to the Secretary. In order to assist the Department's assessment of the harm a potential misrepresentation caused a borrower, the borrower, in submitting a defense to repayment claim, might also be required to submit information about whether, for reasons other than the education received, the borrower has been removed from a job due to on-the-job-performance, disqualified from work in the field for which the borrower trained, or working less than full-time in the chosen field. In addition, the Secretary proposes to include a provision emphasizing to borrowers submitting affirmative or defensive claims that if the borrower receives a 100 percent discharge for the loan, the institution has the right to withhold an official transcript for the borrower, to avoid any confusion or surprise that would result from such withholding. Finally, the regulations make clear that the Secretary will also review both the borrower's claim and the institution's response in making a defense to repayment decision.

Additional Borrower Defense to Repayment Application Process Proposals

At the negotiated rulemaking sessions, the Department proposed that the regulations could allow borrowers to ask the Secretary to reconsider a denial of a defense to repayment, if the reconsideration claim was supported by newly discovered evidence. The negotiating committee discussed variations on this reconsideration process idea, in which either the school or the borrower could submit additional evidence to the Department. Negotiators also proposed that the regulations include an early dispute resolution process, whereby the Department or another party would mediate borrower defense disputes between a borrower and the school, to attempt to resolve the dispute without the need for the parties to go through the Department's full borrower defense adjudication process.

Under our proposed process for adjudicating defenses to repayment, a defense to repayment would be submitted in response to the Department's collection actions on a defaulted loan on a form approved by Secretary, and the Department's Federal Student Aid office will make a decision on the defense to repayment based on the submissions from the borrower and the school, if any. The borrower and the school will each be afforded the opportunity to see and respond to evidence provided by the other.

The reconsideration process proposed by some members of the negotiated rulemaking committee would involve either the borrower or the school submitting additional, newly discovered, evidence to the Department. Under the process and standard included in these proposed regulations, the Department expects to receive and consider all relevant evidence from the borrower and the institution during its consideration of the borrower's defense. Therefore, we do not believe that an appeal process or a process for reconsideration will be needed, nor is one included in these proposed regulations.

With regard to the proposed early dispute resolution process, the Department does not believe such a process is appropriate within the proposed regulations governing borrower defense. A borrower and a school may pursue voluntary resolution of a claim by the borrower at any time, without the involvement of the Department. A borrower may also pursue relief through his or her state consumer protection agency.

Group Process

A group of negotiators proposed that the Department establish a process for considering groups of borrower defenses to repayment claims. They argued that groups of borrowers who were all subject to the same act or omission by a school should have their defenses considered together as a group. These negotiators also asserted that a group process in these cases would be more efficient and would result in more equitable treatment of similarly situated borrowers.

The 2016 final regulations provided for a group process. Specifically, the Secretary could initiate, upon consideration of factors including, but not limited to, common facts and claims, fiscal impact, and the promotion of compliance by the school or other title IV, HEA program participant, a process to determine whether a group of borrowers has a legitimate borrower defense claim. Those regulations provided for the Secretary to identify groups comprised of borrowers who individually filed applications, as well as borrowers who did not file applications, should those borrowers have common facts and claims. 81 FR 76084. The Department further differentiated the processes based upon whether the subject school was open or closed. 81 FR 76085.

The Department does not include a group process, whether the school in question is open or closed, in these proposed regulations. Because relief through a borrower's defense to repayment claim is based not just on evidence of misrepresentation, but also evidence that the borrower reasonably relied on the misrepresentation in deciding to enroll or continue enrollment in the institution, and was harmed by the misrepresentation, the Department must consider each borrower's claim independently. The Department recognizes that a group of borrowers with defaulted loans who are each subject to a proceeding to collect on a Direct loan may assert misrepresentation on the part of the same school based on the same facts and circumstances, such as when the student borrowers were enrolled in a program that the school advertised to the public as being fully accredited by a specific programmatic accrediting agency when, in fact, it was not so accredited. The Department may, at its discretion, determine it is more efficient to establish facts regarding claims of misrepresentation put forth by a group

of borrowers. However, in approving an individual defense, the Secretary would still need to determine that the borrower made a decision based on the misrepresentation, that the borrower was harmed by the misrepresentation, and to what, if any, amount of or type of relief the borrower is entitled. To make that determination, it will be necessary to have a completed application from each individual borrower, and to examine the facts and circumstances of each borrower's individual situation. In addition, it would be inappropriate to subject borrowers who did not individually submit defense to repayment claims to the possible collateral consequences of debt relief, including potentially having their transcript withheld.

Relief

Proposed § 685.206(d)(9) would provide that the Secretary would decide the amount of financial relief provided to the borrower upon the determination of an approved defense to repayment discharge. As part of this determination, the amount of relief awarded to a borrower during the defense to repayment process would be reduced by any amounts that the borrower received from other sources based on a claim by the borrower that relates to the same loan and the same misrepresentation by the school as the defense to repayment. The rule would prevent a double recovery for the same injury at the expense of the Federal taxpayer.

As noted in the preamble to the 2016 final regulations, the Department has a responsibility to protect the interests of Federal taxpayers as well as borrowers. As a result, we continue to believe that establishing a legal presumption of full relief would not be appropriate. *See, e.g.,* 81 FR 75973–75974. While the Department's other loan discharge processes for closed school discharges, 34 CFR 685.214; false certification, 34 CFR 685.215; and unpaid refunds, 34 CFR 685.216, do provide for full loan discharges and recovery of funds paid on subject loans, the factual premises for such discharges are clearly established in statute and are relatively straightforward. In contrast, we anticipate that determinations for borrower defense claims will involve more complicated issues of law and fact since students may have been told different things by different representatives of an institution or may have heard the same statements differently. In many instances, borrower defense claims assert that an admissions representative made certain claims or promises, and yet without a recording of the actual conversation, it is hard to know precisely what was said, the degree to which the borrower relied on that information to make an enrollment decision, and the harm that came from the decision.

In the NPRM for the 2016 final regulations, the Department proposed certain methodologies for calculating relief, 81 FR 39420, but ultimately did not include those in light of their confusing nature, 81 FR 75976. Instead, the Department stated that it would consider factors such as the value of the education provided by the school and the student's cost of attendance, as well as conceptual, non-binding examples for substantial misrepresentation claims. *See* 81 FR 76086–76087. The Department proposes to allow for partial relief, based on the degree of harm suffered by the borrower. Given the complexity of such determinations, however, the Department invites comments on this proposal and on methods for calculating partial relief in connection with defenses to repayment. We also propose to rescind the application provisions of the 2016 final regulations.

Recovery From The School (§§ 685.206 and 685.308)

Statute: Section 455(h) of the HEA authorizes the Secretary to specify in regulation which acts or omissions of an institution of higher education a borrower may assert as a defense to repayment of a Direct Loan.

Current Regulations: Section 685.206(c)(3) states that the Department may initiate an appropriate proceeding to require a school whose act or omission resulted in a successful borrower defense to repayment to require the school to pay the Department the amount of the loan to which the defense applies. It specifies that this proceeding may not be initiated after the period of record retention required in § 685.309(c), unless the school received notice of the borrower's defense during that period.

Proposed Regulations: Proposed § 685.206(d)(13) would clarify that, for borrower defense to repayment discharges granted under the new Federal standard, the Secretary may initiate, within five years of the date of the final determination of the borrower's defense to repayment application, an appropriate proceeding to require a school whose misrepresentation resulted in an approved borrower defense to repayment discharge to pay the Department the amount of the discharged loan. The recovery proceeding would be conducted in accordance with 34 CFR part 668 subpart G.

Proposed § 685.206(d)(11) would require that a borrower who has received a defense to repayment loan discharge reasonably to cooperate with the Secretary in any proceeding to recover funds from the school. The Secretary may revoke relief granted to a borrower who does not fulfill this obligation. Proposed § 685.206(d)(12) would require a borrower whose defense to repayment is successful to transfer to the Secretary any right to recovery against third parties of any amounts discharged by the Department, based on the borrower's defense to repayment.

Conforming changes would be made by proposed §§ 685.300 and 685.308 related to the agreements signed by schools to participate in the Direct Loan Program and to remedial actions that the Department may take to require repayment of funds from schools in various circumstances, respectively.

Reasons: Proposed § 685.206(d)(13) would establish that the Secretary may initiate a recovery proceeding to require the school whose act or omission resulted in the borrower's successful defense to repayment discharge of a Direct Loan to pay to the Secretary the amount discharged. The Department proposes the subpart G hearing as a mechanism for recovery of funds from schools resulting from a borrower defense to repayment discharge. These proceedings are well established in regulation and familiar to schools. The subpart G hearing offers due process to schools, with an opportunity for a preconference hearing via telephone, an informal meeting, or a paper process; submission of evidence; and a hearing. The burden of proof rests with the Department, and the school has an opportunity to appeal the decision of the hearing official to the Secretary.

Proposed § 685.206(d)(11) would help to ensure that the Department receives the borrower's cooperation, if needed, in any proceeding against the school. It is similar to the requirements applicable to other loan cancellation provisions. Cooperation includes providing testimony regarding any representation made by the borrower to support a successful borrower defense to repayment, and producing, within timeframes established by the Secretary, any documentation reasonably available to the borrower with respect to those representations and any sworn statement required by the Secretary with respect to those representations and documents.

In the preamble to the 2016 final regulations, 81 FR 75929–75932, the Department explained that it has the legal authority to recover liabilities from

schools related to approved borrower defenses to repayment. The Department continues to maintain that it has this authority under its statutory and existing regulatory framework as part of its responsibility to administer the Direct Loan Program for the reasons stated in the preamble to those regulations. We note that this has been the Department's consistent position on borrower defenses to repayment, as is reflected in the existing borrower defense to repayment regulation at 34 CFR 685.206(c)(3).

Consistent with the Department's longstanding view, we propose in these regulations to add language to 34 CFR 685.300 regarding Program Participation Agreements schools must sign to participate in the Direct Loan Program. This language would clarify that schools are responsible to the Department for the amounts of the loans underlying approved borrower defense claims, as well as those for other Direct Loan discharges (closed school discharges, false certification discharges, and unpaid refund discharges) approved under the Department's other regulations. The Department also proposes to amend 34 CFR 685.308 to make corresponding changes clarifying that the Department may take remedial actions to recover such losses. The Department also proposes to rescind the recovery from schools provisions of the 2016 final regulations.

Statute of Limitations for Recovering Funds From Schools (§§ 685.206 and 685.308)

The negotiators discussed whether to impose a time limit on the Department's ability to recover losses for the amount of an approved borrower defense to repayment from a school. Negotiators noted that current § 685.206(c)(3) imposes a three-year limit on the Secretary's ability to initiate an action based on the period for the retention of records described in § 685.309(c). This three-year limit is derived from §§ 668.24 and 685.309(c), which describe the requirement to retain ''program records''—records of the determination of eligibility for Federal student financial assistance and the management of Federal funds provided to the school. Section 668.24(e)(2) provides that the school must keep records of borrower eligibility and other records of its ''participation'' in the Direct Loan Program for three years after the last award year in which the student attended the school. In these proposed regulations, we maintain this time limit for recovery actions on approved borrower defense to repayment claims for loans first disbursed before July 1, 2019.

We propose to extend that time limit to five years from the date of the Department's final determination on the borrower's defense to repayment for loans first disbursed after July 1, 2019. Although, as explained above, the Department does not view liabilities from borrower defense to repayment as fines, penalties, or forfeitures, a five-year limitation period is used in other contexts by the Federal government, such as in enforcement actions. *See* 28 U.S.C. 2462. Further, given that the Department does not have a basis for recovery against a school until a borrower defense to repayment has been approved, we believe that the five years should run from the final determination of a borrower's defense to repayment claim, instead of from the last award year the borrower attended school. Therefore, we propose in these regulations that for loans first disbursed on or after July 1, 2019, the Secretary will provide notice to the school of the defense to repayment application and will not initiate such a proceeding more than five years after the date of the final determination of the borrower's defense to repayment. We also propose to rescind the statute of limitations provisions of the 2016 final regulations.

Pre-Dispute Arbitration Agreements and Internal Dispute Processes (§§ 668.41 and 685.304)

Statute: Section 485(a) of the HEA identifies information that participating schools must provide to prospective and enrolled students. Sections 485(b) and (l) of the HEA establish counseling requirements for borrowers of Federal student loans. Section 454(a) of the HEA authorizes the Secretary to specify in regulation the requirements for school participation in the Direct Loan program.

Current Regulations: Section 668.41 describes the information a school must report and disclose to prospective and enrolled students. Section 668.41(a) defines terms used in the regulation. Section 685.304 describes the required entrance counseling that schools must provide to Federal Direct Loan borrowers prior to making the first disbursement of a Federal Direct student loan.

Proposed Regulations: We propose a new § 668.41(h), which would require schools that use pre-dispute arbitration agreements or class action waivers as a condition of enrollment to disclose that information in writing in an easily accessible format to students, prospective students, and the public. We propose to add definitions to paragraph (h)(2) for the terms ''class action,'' ''class action waiver,'' and ''pre-dispute arbitration agreement.'' We propose to define ''class action'' to mean a lawsuit or an arbitration proceeding in which one or more parties seeks class treatment pursuant to Federal Rule of Civil Procedure 23 or any State process analogous to Federal Rule of Civil Procedure 23. We propose to define ''class action waiver'' as any agreement or part of an agreement between a school and a student that relates to the provision of educational services for which the student received title IV funding and prevents an individual from filing or participating in a class action that pertains to those services. We propose to define ''pre-dispute arbitration agreement'' as any agreement or part of an agreement between a school and a student requiring arbitration of any future dispute between the parties relating to the making of a Direct Loan or provision of educational services for which the student received title IV funding.

We also propose to make other revisions to § 668.41: revising paragraph (a) to amend the definition of ''undergraduate students'' to specify that such students are those enrolled in a program ''at or'' below the baccalaureate ''level,'' and revising paragraph (c) to add cross-references to new § 668.41(h).

Proposed revisions to § 685.304 would require schools that require borrowers to accept pre-dispute arbitration agreements or class action waivers as a condition of enrollment to (1) clearly, and in plain language, provide written explanation to the borrower of the nature and application of the pre-dispute arbitration agreement and/or class action waiver, and (2) provide to the borrower written information on the availability of the school's internal dispute resolution process.

Reasons: Current regulations do not address the use of pre-dispute arbitration agreements or class action waivers in enrollment agreements between schools and students or in other documents that must be signed by the student as a condition of enrollment.

In 2016, the Department issued regulations that prohibited a school participating in the Direct Loan Program from enforcing class action waivers or pre-dispute arbitration agreements against borrowers with Direct Loans for claims that may form the basis of a borrower defense to repayment claim. The 2016 final regulations required participating schools to ''forgo reliance on any pre-dispute agreement with a student that waives the student's right

to participate in a class action against the school related to a borrower defense claim.'' 81 FR at 75927, 76088. However, the 2016 regulations did permit a borrower to enter into a voluntary post-dispute arbitration agreement with a school to arbitrate a borrower defense claim. For these voluntary post-dispute arbitrations, the Department required institutions to submit copies of the arbitral filings, responses, awards, and certain other documents to the Secretary within 60 days of the filing or receipt by the school, as applicable. The Department also required schools to submit certain judicial records of lawsuits filed as to claims related to borrower defense to repayment.

Since issuance of the 2016 final regulations and subsequent delay of their effective date, schools have been allowed to continue enforcing pre-dispute arbitration agreements, and the Department has heard from students, advocates representing students, and the public about this practice. Many of these groups told the Department that the implications of class-action waivers or pre-dispute arbitration agreements can be unclear to students when they enroll at a school. These groups urged the Department to take steps to provide increased protection for student loan borrowers. Other negotiators argued that students are and can be well-served by the arbitration process, which they contend can be a more efficient, timely, and cost-effective option for dispute resolution.

The Department is aware of court decisions holding that prohibitions on pre-dispute arbitration agreements and class action waivers violate the Federal Arbitration Act (FAA). The FAA ''establishes a liberal federal policy favoring arbitration agreements'' that applies ''unless the FAA's mandate has been overridden by a contrary congressional command.'' *CompuCredit Corp.* v. *Greenwood,* 565 U.S. 95, 98 (2012). This policy protects the right of parties to set dispute resolution procedures by contract.

In the 2016 regulations, the Department took the position that the HEA gives the Department broad authority to impose conditions on schools that wish to participate in a Federal benefit program and that regulation of the use of pre-dispute arbitration agreements and class action waivers was necessary to ''protect the interests of the United States and promote the purposes'' of the Direct Loan Program under section 454(a)(6) of the HEA, 20 U.S.C. 1087d(a)(6). We recognize, as explained in the preamble to the 2016 final regulations, that pre-dispute arbitration agreements and class action waivers may, in some circumstances, not be well understood by consumers or facilitate the Department's awareness of potential issues faced by students at a school. However, our reweighing of the issue and subsequent legal developments have led us to believe that the Department should take a position more in line with the strong Federal policy favoring arbitration.

We believe that arbitration offers a number of potential advantages in this context. Arbitration may, for example, be more accessible to borrowers since it does not require legal counsel and can be carried out more quickly than a legal process that may drag on for years. It may also allow an institution to more quickly identify and stop bad practices to ensure that other students are not harmed. It may also allow borrowers to obtain greater relief than they would in a consumer class action case where attorneys often benefit most. And it may reduce the expense of litigation that a university would otherwise pass on to students in the form of higher tuition and fees. Arbitration also eases burdens on the overtaxed U.S. court system.

Our reexamination of the legal landscape also weighs in favor of the Department's proposal not to disrupt pre-dispute arbitration agreements or class-action waivers. In particular, the U.S. Supreme Court recently held that the FAA governs, unless Congress ''manifests a clear intention'' to displace it, and that arbitration agreements ''must be enforced as written.'' *Epic Systems Corp.* v. *Lewis,* 584 U.S.—, 2018 WL 2292444 at 17 (May 21, 2018). Thus, in *Epic Systems Corp* v. *Lewis,* the Court declined to afford deference to the National Labor Relations Board's reading of the National Labor Relations Act (NRLA) to trump FAA policy—even though an agency's interpretation of its own statute normally receives deference. *Id.* Nothing in the NLRA manifested Congress's clear intention to displace the FAA, and the FAA accordingly controlled.

Epic Systems is consistent with the Supreme Court's earlier decision holding that a prohibition on class arbitration waivers in consumer contracts violates the FAA, *AT&T Mobility LLC* v. *Concepcion,* 563 U.S. 333, 347–51 (2011). We believe that the Supreme Court's recent reaffirmation of the Federal policy in favor of arbitration may warrant a different approach to these regulations.

That belief is further supported by recent congressional action. Specifically, Congress passed, and the President signed, a joint resolution disapproving a final rule published by the Bureau of Consumer Financial Protection (BCFP) that would have regulated pre-dispute arbitration agreements in contracts for specified consumer financial products and services. That proposed rule was informed by the same extensive study conducted by the BCFP on the impact of such agreements that the Department relied on in its rationale for the pre-dispute arbitration and class action waiver provisions in the 2016 final regulations. In light of Congress' clear action, the Department believes a change in its position to align with the strong Federal policy in favor of arbitration is appropriate.

The Department thus proposes to revise its treatment of pre-dispute arbitration agreements and class action waivers. It is not currently proposing to ban such agreements or waivers. And given the burden to the Department of reviewing such records, the Department is also not proposing that institutions be required to report information about arbitration awards or judicial proceedings to the Secretary. However, the Department acknowledges negotiators' concerns that borrowers and students may not understand the implications of arbitration agreements and class action waivers that may be included in their agreements with the school.

The Department agrees that it is important that students understand what a pre-dispute arbitration agreement or class action waiver means, so that students can elect to enroll at an institution that does not include such provisions if the student so desires. Also, it is important for a student who attends an institution that requires arbitration to know how to access and utilize arbitration, thus the requirement that schools relying upon mandatory arbitration provide plain language instruction on both the meaning of this restriction and the ways a student can access it. Thus, the Department is proposing regulatory changes to promote greater transparency by schools that require students to enter into such agreements as a condition of enrollment, to allow borrowers the opportunity to make an informed choice as to whether to enroll in such schools.

During the negotiated rulemaking sessions, the Department proposed including in the regulations a requirement that schools including pre-dispute arbitration agreements or class action waivers in their enrollment agreements clearly disclose that information to prospective and continuing students, and educate borrowers during loan entrance

counseling about pre-dispute arbitration agreements, class action waivers, and the schools' internal dispute processes. Negotiators expressed two distinct points of view about the value of arbitration: Some believed that an internal dispute resolution process or arbitration proceeding serves the best interests of students, schools, and taxpayers. They noted that the Department, as well as accreditors, direct students with complaints to first attempt to resolve those complaints with the school. And some of those negotiators also asserted that arbitration can be quicker and less expensive than a court proceeding, provide meaningful relief to the student at the school's (rather than the Federal taxpayers') expense, and allow schools to resolve issues with students outside of the courts. In contrast, other negotiators expressed concerns that requiring students to use an internal dispute resolution process or arbitration, or prohibiting students from joining class action lawsuits, was more likely to suppress students' meritorious claims against their schools.

Negotiators also differed as to the benefits of increased transparency about such agreements. Some negotiators supported the Department's proposal, asserting that it would enable prospective and continuing students to make an informed choice before taking out a Federal student loan to enroll or continue enrollment at a school that required these agreements. They also noted that, if these processes are beneficial to students, as asserted by some schools, this would be an additional reason for highlighting them in the enrollment and student loan application processes. One negotiator expressed concern that the Department's initial proposed language was too broad and could apply to arbitration agreements unrelated to the school's provision of educational services, such as arbitration agreements relating to the use of campus parking facilities or other student services.

After hearing from the negotiators, and for the foregoing reasons, the Department has concluded that it is better to require schools to disclose the existence of pre-dispute arbitration agreements and class action waivers, rather than, as was done in 2016, outright ban these practices. We acknowledge one negotiator's concern about the Department's initial proposed language and have altered the proposed definition of ''pre-dispute arbitration agreement'' to make clear that the requirement applies only to agreements requiring arbitration of any future disputes between the parties relating to the making of a Direct Loan or the provision of educational services for which the student received title IV funding. The Department believes that it would be burdensome to schools and the Department to require submission of arbitration documentation (which also may contain confidential information) and are not proposing to include this requirement here. We therefore propose to rescind our 2016 final regulations that banned pre-dispute arbitration agreements and class action waivers, as well as the requirement that schools using arbitration submit specific documentation to the Department.

Closed School Discharges (§§ 674.33, 682.402, and 685.214)

Statute: Sections 437(c) and 464(g)(1) of the HEA provide for the discharge of a borrower's liability to repay a FFEL Loan or a Perkins Loan if the student is unable to complete the program in which the student was enrolled due to the closure of the school. The same discharge is available to Direct Loan borrowers under section 455(a) of the HEA.

Current Regulations: Sections 674.33(g), 682.402(d), and 685.214 describe the qualifications and procedures in the Perkins, FFEL, and Direct Loan Programs for a borrower to receive a closed school discharge. Under §§ 674.33(g)(4), 682.402(d)(3), and 685.214(c), a Perkins, FFEL, or Direct Loan borrower, respectively, must submit a written request and supporting sworn statement, under penalty of perjury, to apply for a closed school discharge. Sections 674.33(g)(4)(i)(B), 682.402(d), and 685.214 provide that, to qualify for a closed school discharge a student must have been enrolled in the school at the time it closed or must have withdrawn from the school not more than 120 days before the school closed. The regulations also provide that the Secretary may extend the 120-day window under exceptional circumstances. Sections 674.33(g)(4)(i)(C), 682.402(d)(3)(ii)(C), and 685.214(c)(1)(i)(C) provide that a borrower may qualify for a closed school discharge if the borrower did not complete, and is not in the process of completing, the program of study through a teach-out at another school.

Proposed Regulations: Proposed revisions to §§ 674.33(g)(4), 682.402(d)(3) and (d)(6)(ii)(G) and (H), and 685.214(c) would replace the requirement that, to apply for a closed school loan discharge, the borrower submit a sworn statement with a requirement that the borrower submit a completed application signed under penalty of perjury.

Proposed revisions to §§ 674.33(g), 682.402(d), and 685.214(c) would extend the window for a borrower to qualify for a closed school discharge based on withdrawal from a closed school without completion of a program from 120 days before the school closed to 180 days, and would modify some of the examples of ''exceptional circumstances'' under which the Secretary may extend the proposed 180-day period.

Proposed §§ 674.33(g)(4)(i)(D), 682.402(d)(3)(iii), and 685.214(c)(1)(ii) would state that if a closing school provided an opportunity to a borrower to complete the program of study while the school was still open by allowing students to complete their program of study before shutting down through an orderly closure (referred to by accreditors as a teach-out) approved by the school's accrediting agency and, if applicable, the school's State authorizing agency, the borrower would not qualify for a closed school discharge.

Proposed revisions to § 682.402(d)(6)(ii)(F) would require a guaranty agency that denies a closed school discharge request to inform the borrower of the opportunity to request a review of the guaranty agency's decision by the Secretary and explain how the borrower may request that review. Proposed § 682.402(d)(6)(ii)(J) would describe the responsibilities of the guaranty agency and the Secretary if the borrower requests a review.

Reasons:

Application Process

The current regulations refer to a borrower submitting a sworn statement made under penalty of perjury, but borrowers now apply for closed school discharges by filing a Federal closed school discharge application. This application includes several certifications that the borrower must make under penalty of perjury. The closed school discharge application takes the place of the sworn statement that was formerly required, and several of our proposed revisions to the regulations reflect that change.

In the 2016 regulations, the Department included provisions that provided automatic closed school discharges for borrowers who have not re-enrolled in a Title IV-eligible institution within three years of their schools' closures. See, *e.g.,* 81 FR at 76038.

During the 2017–2018 negotiations, some negotiators proposed that the Department also provide for an automatic closed school discharge in certain circumstances. The negotiators

proposed that a borrower who attended a closed school and who did not re-enroll within one year, or, alternatively, three years, of the school closing be granted a closed school discharge without being required to submit an application.

In these regulations, we are not proposing an automatic closed school discharge. Under existing §§ 674.33(g)(3)(ii), 682.402(d)(8), and 685.214(c)(2), the Department may grant a closed school discharge without an application if the Secretary determines, based on information in the Secretary's (or, in the case of a FFEL loan, the guaranty agency's) possession that the borrower qualifies for the discharge. Thus, the Secretary already has the authority to grant a discharge without an application in appropriate cases at her discretion, and, therefore, we do not believe that it is necessary to establish in the proposed regulations a requirement that the Secretary grant automatic closed school discharges. In addition, because an institution (or the entity maintaining records from a closed school) might withhold official transcripts of borrowers who received a defense to repayment of closed school discharge, automatic discharges could have collateral consequences for students who did not opt-in.

Furthermore, through these proposed regulations, the Department is encouraging schools that are closing to go through an orderly closure, which includes offering appropriate teach-outs to their students. Under the proposed regulations, students who decline to participate in an appropriate teach-out, when made available by the institution and approved by the accreditor (and, if applicable, State authorizing entities) are not eligible for a closed school discharge. An application will be useful, and in some cases necessary, for the Department to determine whether the student was provided with an appropriate opportunity to complete a teach-out. For these reasons, we are proposing to rescind the regulations concerning automatic closed school discharge that were part of the 2016 final regulations.

Extending the Window To Qualify for a Closed School Discharge From 120 Days to 180 Days

The HEA provides that a borrower may receive a closed school discharge if the borrower ''is unable to complete the program in which the student is enrolled due to the closure of the institution,'' (sections 454(g)(1) and 437(c)(1)) but does not establish a period prior to the closure of the school that a borrower may withdraw and still qualify for a closed school discharge. The Department has nevertheless long interpreted the statute to allow discharge for students who withdraw a short time before a school closure, recognizing that a precipitous closure may be preceded by degradation in academic quality or student services. In 2013, the Department expanded the window for eligibility for a closed school loan discharge from 90 to 120 days, meaning that students who withdraw from the school within 120 days of the school's closure are eligible for closed school loan discharge.

In the 2016 final regulations, the Department determined that the 120-day look-back period to qualify for closed school discharge in current regulations is sufficient. The Department noted that under current regulations in § 685.214(c)(1)(B), it has the authority to extend the look-back period due to ''exceptional circumstances.'' At that time, we believed that this provision provided appropriate flexibility to the Department in cases where it may be necessary to extend the look-back period. *See* 81 FR at 76040.

However, during the 2017–2018 negotiated rulemaking sessions, the Department proposed to extend the window for a borrower to qualify for a closed school discharge from 120 days to 150 days, and most negotiators supported that proposal. Some negotiators expressed concerns that extending the window to 150 days would significantly increase the number of borrowers who could qualify for a closed school discharge, even if those borrowers could have graduated before the school closed. They also noted that closed school discharges apply to locations of a school that are closed, not just to schools that have closed entirely, and many large universities have campuses at different locations that they may choose to close in a responsible, planned manner. One negotiator noted that schools often engage in short-term partnerships with private entities to provide instruction at specific off-campus locations. Even though such programs may be intended to last for only a short term to address a specific need in the community, students attending the school at these locations could qualify for closed school discharges. In the view of these negotiators, extending the window for eligibility for a closed school discharge could have the effect of discouraging innovation and creativity by schools involving other locations.

Some negotiators expressed concern that a longer window could lead to strategic behavior on the part of borrowers. For example, if a borrower is aware that a school will be closing, the borrower could continue to attend the school and take out more loans, with the intention of getting the loans discharged once the school closes. These borrowers may be unaware that the institution might withhold official transcripts from students who receive closed school discharges. Since a longer window under which a borrower could qualify for a closed school discharge would also increase the opportunity for a borrower to complete the program in a school that is planning to close, these negotiators argued that a borrower should not qualify for a closed school discharge if the borrower could have completed the program before the school closure date.

Other negotiators did not agree that borrowers should be ineligible for a closed school discharge if they could have completed the program at the school prior to its closure. They pointed out that schools that close precipitously may show symptoms of failing months before the actual closure date. These negotiators stated that they have seen evidence of degradation in their interactions with such schools as teachers and administrative staff members leave and the quality of services provided by the school deteriorates. In the view of these negotiators, borrowers at such schools should qualify for a closed school discharge, even if they could have stayed at the failing school and completed their program before the school officially closed its doors.

Some of these negotiators proposed extending the window for a closed school discharge to a year, since, in their view, a school that closes may have problems well in advance of the actual closure date. The negotiators pointed out that a school that only planned to open a location temporarily, or that engaged in a planned, responsible closure of a location, could stop accepting new students at the location, and commit to allowing the current students to complete their studies at the location before shutting down—in other words, conduct an orderly closure under an approved teach-out plan—to avoid a dramatic expansion of the borrowers entitled to closed-school discharge under this longer look-back period.

Other negotiators objected strongly to the proposal to extend the window to a full year. They stated that this would put schools in the position of having to track every student who may have withdrawn or transferred during that one-year period until those students completed a program at another school, creating a ''quagmire'' for schools.

Based on the feedback we received and the Department's recent experience with precipitous school closures, the Department is proposing to extend the period to 180 days—60 days longer than provided in the current regulations. We believe that 180 days makes the most sense because it takes into account the situation in which, as a result of the summer break during which time many institutions offer few or no classes, a student who withdraws one semester prior to a school's precipitous closure could have withdrawn as many as 180 days earlier.

Exceptional Circumstances

The Department proposes clarifications and modifications to §§ 674.33(g)(4)(i)(B), 682.402(d), and 685.214 that provide examples of ''exceptional circumstances'' under which the Secretary may extend the period of time to provide a closed school discharge. For example, we propose replacing the reference in the existing regulations to the ''loss of accreditation'' with language referring to ''revocation or withdrawal by an accrediting agency of the school's institutional accreditation.''

Generally, the negotiating committee approved of these changes. One negotiator proposed adding an additional exceptional circumstance: The school's discontinuation of the student's program of study. However, other negotiators noted that the closed school discharge is intended for closed school situations, not situations in which a school terminates an academic program. These negotiators believed that adding a reference to the discontinuation of a student's academic program in the ''extenuating circumstances'' provision would be inconsistent with the statutory intent of the closed school discharge. Because the closed school discharge regulations are intended to address the closure of an entire school or branch campus, as opposed to discontinuation of a specific program offered at such a location, we agree with these negotiators. Therefore, we have declined to include this additional exceptional circumstance in the proposed regulations.

Teach-Out Plans, Orderly Closures and Transfer of Credits

Under these proposed regulations, we are proposing that students who are provided an opportunity to complete their program through a teach-out plan or an orderly closure approved by the school's accreditor and, if applicable, the school's State authorizing agency would not have the right to receive a closed school discharge as long as the school upheld the conditions of the teach-out plan or orderly closure. We believe that closing schools should be encouraged to offer accreditor-approved and, if applicable, State authorizer-approved teach-out plans and orderly closures to allow students the reasonable opportunity to complete the academic programs, either at another location after the school has closed, or by continuing to offer classes to students until they have completed their program of study before the school officially closes.

One negotiator noted that while closing schools may conduct orderly closures or offer teach-out plans, a borrower can choose not to participate in an orderly closure or a teach-out plan. This negotiator argued that a borrower should not qualify for a closed school discharge if he or she could have completed the program through an orderly closure or through a teach-out plan, but chose not to do so. In this negotiator's view, the law is written to encourage borrowers in closed school situations to complete their programs under the approved teach-out plan or through an orderly closure and not to receive closed school discharges.

We agree that borrowers who have a reasonable opportunity to complete their academic programs through an orderly closure or a teach-out plan should not qualify for a closed school discharge, if the orderly closure or the teach-out plan has been approved by the school's accrediting agency and, if applicable, the school's State authorizing agency. In such cases, the closure of the school did not render the student unable to complete the program in which the student was enrolled. Borrowers who attend closing schools may be better served by completing their programs, either at the school or at another school through a teach-out plan, than by having their loans forgiven and being required to start their education over at another institution. Students should be encouraged to complete their academic program, not to have their loans discharged. And schools should be encouraged to provide their students with an opportunity to do so. It is for this reason that accreditors are required to review and approve a school's teach-out plan if the institution is at risk for closure.

Department Review of Guaranty Agency Denial of a Closed School Discharge Request

In the Perkins Loan and Direct Loan Programs, closed school discharge determinations are made by the Department. The Department is the loan holder for all Direct Loans and becomes the loan holder for Perkins Loans held by a school that closes. In the FFEL Program, closed school discharge determinations are generally made by the guaranty agency. The current FFEL Program regulations do not specifically provide an opportunity for a review of the guaranty agency's determination of a borrower's eligibility for a closed school discharge. Proposed § 682.402(d)(6)(ii)(F) would provide an opportunity for the borrower to receive Departmental review of closed school discharge claims which have been denied by the guaranty agency to provide a more complete review of the claims, comparable to that provided for false certification discharge claims.

A negotiator pointed out that existing regulations allow the Department to review closed school discharge application denials for Direct Loan borrowers. This proposal is intended to establish parity between the FFEL and Direct Loan programs with regard to the review of closed school discharge applications.

Additional Closed School Discharge Proposals

The negotiated rulemaking committee also discussed several additional proposed revisions to the closed school discharge regulations.

Some negotiators proposed adding a provision specifying that a borrower who graduated prior to the school's closure could not qualify for a closed school discharge. The Department does not need to add such a provision. A borrower who graduates prior to the closure of a school is already ineligible for closed school discharge because the student has completed his or her program of study and received a credential.

One negotiator proposed narrowing the scope of the closed school discharge by disqualifying a borrower from a closed school discharge if the borrower completed a ''comparable program'' of study at another school. Another negotiator suggested defining ''comparable program'' as meaning a program of equal or greater value or quality, based on academic outcomes, graduation rates, and default rates. Another negotiator recommended determining ''comparable program'' based on the Classification of Instructional Programs (CIP) code plus credential level. However, other negotiators expressed concerns that this proposal might push borrowers into programs in which they originally did not intend to enroll. They expressed concern that a student may be pushed into a program that is not really ''comparable'' to the borrower's original

program. A student may enroll in the program because there is nothing else comparable nearby, although the better option for the student would have been to apply for the closed school discharge. Other negotiators questioned the value of adding the ''comparable program'' language at all. One negotiator suggested that, since a borrower can transfer credits to another program, there is no need to explicitly use or define the term ''comparable program'' in the regulations.

Given the uncertain statutory authority for, or effect of adding the ''comparable program'' language suggested by the negotiator, the Department declines to propose including such a provision in the regulations.

False Certification Discharges (§ 685.215)

Statute: Section 437(c) of the HEA provides for the discharge of a borrower's liability to repay a FFEL Loan if the student's eligibility to borrow was falsely certified by the school. The false certification discharge provisions also apply to Direct Loans, under the parallel terms, conditions, and benefits provision in section 455(a) of the HEA. Section 484(d) of the HEA specifies the requirements that a student who does not have a high school diploma or a recognized equivalent of a high school diploma must meet to qualify for a title IV, HEA loan.

Current Regulations: Section 685.215(a)(1)(i) provides that a Direct Loan borrower may qualify for a false certification discharge if the school certified the eligibility of a borrower who was admitted on the basis of the ability to benefit, but the borrower did not in fact meet the eligibility requirements in 34 CFR part 668 and section 484(d) of the HEA, as applicable. Section 685.215(c) and (d) describes the qualifications and procedures for receiving a false certification discharge.

Proposed Regulations: The proposed changes to § 685.215(a)(1)(i) would eliminate the reference to ''ability to benefit'' and specify that a borrower qualifies for a false certification discharge if the borrower reported not having a high school diploma or its equivalent and did not satisfy the alternative to graduation from high school requirements in 34 CFR part 668 and section 484(d) of the HEA. Thus, under proposed § 685.215(a)(1)(i), if a school certified the eligibility of a borrower who is not a high school graduate (and does not meet the applicable alternative to high school graduation requirements) at the time the loan was disbursed, the borrower would qualify for a false certification discharge.

Proposed § 685.215(c) and (d) would update the procedures for applying for a false certification discharge. Proposed § 685.215(c)(1) would describe the requirements a borrower must meet to qualify for a discharge based on a false certification of high school graduation status. Proposed § 685.215(c)(1)(ii) would specify that a borrower who was unable to obtain an official transcript or diploma from his or her high school and, in place of a high school transcript or diploma, submitted a written attestation that the borrower had a high school diploma, does not qualify for a false certification discharge if the borrower actually did not have a high school diploma. The attestation would have to be provided under penalty of perjury.

Reasons:

Application Process

Current § 685.215(c) requires the borrower to submit a ''written request and a sworn statement'' to apply for a false certification discharge. We propose replacing this language with a requirement that the borrower submit an application for discharge on ''a form approved by the Secretary, signed under penalty of perjury,'' to bring the regulations up to date with the current process. Borrowers applying for false certification discharges now submit a Federal false certification discharge application. This application includes several certifications that the borrower must make under penalty of perjury. The false certification discharge application takes the place of the sworn statement that was formerly required.

False Certification of a Borrower Without a High School Diploma or Equivalent

We propose removing the ''ability to benefit'' language from § 685.215(a)(1)(i) because there is no longer a statutory basis for certifying the eligibility of non-high school graduates based on an ''ability to benefit.'' Section 484(d) of the HEA establishes different standards under which a non-high school graduate may qualify for title IV aid. We believe that it is preferable to refer to section 484(d) of the HEA by cross-reference, rather than to incorporate the statutory language in the regulations. Under this approach, the regulatory language will incorporate any current or future alternatives to the high school graduation requirements specified in section 484(d) of the HEA.

Some of the non-Federal negotiators noted that a borrower may provide false information to the school the borrower is applying to attend regarding their high school graduation status. The negotiators asserted that, unless the school investigates the borrower's claim that he or she is a high school graduate—for instance by requesting transcripts, which are harder to falsify than a diploma—the school may unknowingly falsely certify the borrower's eligibility. One negotiator proposed adding language specifying that, for a borrower to qualify for a false certification discharge, the school must be unable to provide to the Department clear and convincing evidence that the student provided the school with evidence of their high school graduation status. The negotiator pointed out that in some instances—for example with homeschooled students—the school basically only has a representation from the student that the student is a high school graduate. Under this proposal, the borrower would have to demonstrate that the school knowingly certified the eligibility of the borrower even though the borrower did not meet the high school graduation requirements.

There was strong disagreement between the negotiators over whether the school must ''knowingly'' falsely certify the high school graduation status of a borrower for the borrower to qualify for a false certification discharge. Some negotiators noted that it is the school's responsibility to determine the borrower's eligibility. If the school does not, and certifies eligibility anyway, the borrower's eligibility may have been falsely certified, and the borrower should qualify for the discharge. Other negotiators felt that a mistaken certification of eligibility should not qualify a borrower for a false certification discharge. One negotiator pointed out that, regardless of whether the school knew if the borrower was a high school graduate, if the school certified a non-high school graduate's eligibility, the borrower's eligibility would still have been falsely certified, and the borrower would still qualify for a false certification discharge. Other negotiators expressed concern with this proposal, noting that borrowers would have a difficult time proving that the school ''knowingly'' falsified the borrower's eligibility.

Under current regulations, a school may be responsible for the repayment of funds related to a false certification discharge due to a school's ''negligent or willful false certification'' (34 CFR 685.308(a)(2)). It would be inconsistent with these requirements to require that a school would have to ''knowingly'' falsely certify a borrower's eligibility for the borrower to qualify for a false certification discharge. However, the

Department believes that schools should be able to rely on an attestation from a borrower that the borrower earned a high school diploma in cases when the borrower is unable to obtain an official transcript or diploma from the high school. Therefore, we are proposing regulatory language that would provide that when a borrower provides an institution an attestation of their high school graduation status for purposes of admission to the institution, they may not subsequently qualify for a false certification discharge based on not having a high school diploma. Moreover, if the institution has confirmed with a State authority that the school was approved by that State to issue high school diplomas at the time of the borrower's graduation from that school, the institution must collect evidence that a student has a bona fide diploma from the school. The school has no additional obligation to collect transcripts or other information in order to certify the student.

A negotiator noted that the current regulations specify that the borrower qualifies for a false certification discharge if the borrower did not have a high school diploma or recognized equivalent at the time the loan was originated. The negotiator pointed out that the loan can be originated but the funds might not be disbursed and suggested that the date of disbursement might be the appropriate date rather than the date of origination. In addition, a borrower could be a senior in high school at the time the loan was originated, with the expectation that the borrower will have graduated high school at the time of enrollment. While a loan can be originated months before a borrower enrolls in a school, it is not disbursed until the student is enrolled.

The Department agrees that using disbursement date rather than origination date would be a more accurate indicator that a school falsely certified a borrower's high school graduation status, and has made that change in the proposed language.

One negotiator suggested amending the regulations to specify that a borrower must have a ''valid high school diploma.'' The negotiator believed that this addition would protect schools from companies that create false diplomas for potential student loan borrowers. Although the 2016 final regulations did not use the phrase ''valid high school diploma,'' those regulations added language to 34 CFR 685.215 intended to state more explicitly that a school's certification of eligibility for a borrower who is not a high school graduate, and who does not meet the alternative to high school graduate requirements, is grounds for a false certification discharge. As explained in the preamble to the NPRM for the 2016 final regulations, the added language was meant to address the problem of schools encouraging students to obtain false high school diplomas to qualify for Direct Loans. *See* 81 FR 39377. Upon further review however, the Department believes that the existing language of 34 CFR 685.215, with its proposed updates for changes in the Department's statutory authority as noted above, already covers such circumstances. The Department accordingly does not propose including such additional language in the regulations proposed in this NPRM, and proposes to rescind these provisions of the 2016 final regulations. A school still falsely certifies a borrower's eligibility if it is aware that a student does not have a high school diploma and encourages the student to obtain a false diploma. The addition of the word ''valid'' to the requirement that a borrower have a high school diploma would not have any meaningful effect, as an ''invalid'' high school diploma would not be a ''high school diploma'' for the purposes of this regulation.

In the 2016 final regulations, the Department also added language to clarify a provision in existing 34 CFR 685.215 that a borrower may receive a false certification discharge of a Direct Loan if the school certified the eligibility of a student who, because of a physical or mental condition, age, criminal record, or other reason accepted by the Secretary, would not meet the requirements for employment in the student's State of residence in the occupation for which the training program for which the loan was provided was intended—or in other words, certified the student despite the fact that the student had a disqualifying status. 34 CFR 685.215(a)(1)(iii). Upon further review, however, the Department believes that the changes in the 2016 final regulations did not alter the operation of the existing regulation as to disqualifying conditions in any meaningful way, and as a result does not propose such added language in these regulations. We, therefore, propose to rescind this provision of the 2016 final regulations.

Finally, in the 2016 final regulations, the Department added that the Department may consider evidence that a school had falsified the Satisfactory Academic Progress (SAP) of its students to determine whether to discharge a borrower's loan without an application from the borrower. 81 FR 76082 (text of 34 CFR 685.215(c)(8)). Existing 34 CFR 685.215 already provides that the Department may discharge a borrower's Direct Loan by reason of false certification without an application. Evaluation of an institution's implementation of their SAP policy is already part of an FSA program review, so there is already a mechanism in place to identify inappropriate activities in implementing an institution's SAP policy. Therefore, the Department declines to include such a provision in the regulations proposed in this NPRM and proposes rescinding this provision of the 2016 final regulations.

Financial Responsibility (§ 668.171 General)

Statute: Section 487(c)(1) of the HEA authorizes the Secretary to establish reasonable standards of financial responsibility. Section 498(a) of the HEA provides that, for purposes of qualifying an institution to participate in the title IV, HEA programs, the Secretary must determine the legal authority of the institution to operate within a State, its accreditation status, and its administrative capability and financial responsibility.

Section 498(c)(1) of the HEA authorizes the Secretary to establish ratios and other criteria for determining whether an institution has the financial responsibility required to (1) provide the services described in its official publications, (2) provide the administrative resources necessary to comply with title IV, HEA requirements, and (3) meet all of its financial obligations, including but not limited to refunds of institutional charges and repayments to the Secretary for liabilities and debts incurred for programs administered by the Secretary.

Current Regulations: The current regulations in § 668.171(a) mirror the statutory requirements that to begin and to continue to participate in the title IV, HEA programs, an institution must demonstrate that it is financially responsible. The Secretary determines whether an institution is financially responsible based on its ability to provide the services described in its official publications, properly administer the title IV, HEA programs, and meet all of its financial obligations.

The Secretary determines that a private non-profit or proprietary institution is financially responsible if it satisfies the ratio requirements and other criteria specified in the general standards under § 668.171(b) and appendix A or B to subpart L of the General Provisions regulations. Under those standards, an institution:

- Must have a composite score of at least 1.5, based on its Equity, Primary Reserve, and Net Income ratios;

• Must have sufficient cash reserves to make required refunds;

• Must be current in its debt payments. An institution is not current in its debt payment if it is in violation of any loan agreement or fails to make a payment for 120 days on a debt obligation and a creditor has filed suit to recover funds under that obligation; and

• Must be meeting all of its financial obligations, including but not limited to refunds it is required to make under its refund policy or under § 668.22, and repayments to the Secretary for debts and liabilities arising from the institution's participation in the title IV, HEA programs.

Proposed Regulations: We propose to restructure § 668.171, in part, by amending paragraph (b) and adding new paragraphs (c) and (d) that provide that an institution does not or may not be able to meet its financial or administrative obligations if it is subject to one or more of the following actions or events:

Mandatory triggering events:

• *Liabilities from borrower defenses to repayment or final judgments or determinations.* After the end of the fiscal year for which the Secretary has most recently calculated an institution's composite score, the institution incurs a liability arising from borrower defense to repayment discharges granted by the Secretary, or a final judgment or determination from an administrative or judicial action or proceeding initiated by a Federal or State entity and as a result of that liability, the institution's recalculated composite score is less than 1.0, as determined by the Secretary under proposed paragraph (e) of this section.

• *Withdrawal of owner's equity.* For a proprietary institution whose composite score is less than 1.5, there is a withdrawal of owner's equity from the institution by any means, including by declaring a dividend (unless the withdrawal is a transfer to an entity included in the affiliated entity group on whose basis the institution's composite score was calculated), and as a result of that withdrawal, the institution's recalculated composite score is less than 1.0, as determined by the Secretary under proposed paragraph (e) of this section.

• *SEC and Exchange Actions for publicly traded institutions.* The SEC issues an order suspending or revoking the registration of the institution's securities pursuant to section 12(j) of the Securities and Exchange Act of 1934 (the ''Exchange Act'') or suspends trading on the institution's securities on any national securities exchange pursuant to section 12(k) of the Exchange Act or the national securities exchange on which the institution's securities are traded delists, either voluntarily or involuntarily, the institution's securities pursuant to the rules of the relevant national securities exchange.

Discretionary triggering events:

• *Accrediting agency actions.* The institution is issued a show-cause order that if not satisfied, would lead the accreditor to withdraw, revoke or suspend institutional accreditation.

• *Loan agreement violations.* The institution violated a provision or requirement in a security or loan agreement with a creditor, and as provided under the terms of that security or loan agreement, a monetary or nonmonetary default or delinquency event occurs, or other events occur, that trigger, or enable the creditor to require or impose on the institution, an increase in collateral, a change in contractual obligations, an increase in interest rates or payments, or other sanctions, penalties, or fees.

• The institution is cited by a State licensing or authorizing agency for violating a State or agency requirement and notified that its licensure or authorization will be withdrawn or terminated if the institution does not take the steps necessary to come into compliance with those requirements.

• *90/10 Revenue Requirement.* For its most recently completed fiscal year, a proprietary institution did not derive at least 10 percent of its revenue from sources other than title IV, HEA program funds, as provided under § 668.28(c).

• *Cohort default rate (CDR).* The institution's two most recent official cohort default rates are 30 percent or greater, as determined under 34 CFR part 668, subpart N, unless the institution files a challenge, request for adjustment, or appeal under that subpart with respect to its rates for one or both of those 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.

Also, we propose to add a new paragraph (e) under which the Secretary would recalculate an institution's most recent composite score for a mandatory triggering event under proposed paragraph (c)(1) by recognizing as an expense the actual amount of the liability incurred by an institution or by accounting for the withdrawal of owner's equity. Specifically, the Secretary would use the audited financial statements from which the institution's most recent composite score was calculated and would account for that expense or withdrawal by:

• For the actual liabilities incurred by a proprietary institution, (1) increasing expenses and decreasing adjusted equity by that amount for the primary reserve ratio, (2) decreasing modified equity by that amount for the equity ratio, and (3) decreasing income before taxes by that amount for the net income ratio.

• For the withdrawal of owner's equity, (1) decreasing adjusted equity by the amount for the primary reserve ratio, and (2) decreasing modified equity by that amount for the equity ratio.

• For the actual liabilities incurred by a non-profit institution, (1) increasing expenses and decreasing expendable net assets by that amount for the primary reserve ratio, (2) decreasing modified net assets by that amount for the equity ratio, and (3) decreasing change in net assets without donor restrictions by that amount for the net income ratio.

In addition, we propose to add a new paragraph (f) under which an institution would be required to notify the Secretary no later than 45 days after the end of its fiscal year if it did not satisfy the 90/10 revenue requirement, and notify the Secretary no later than 10 days after any other mandatory or discretionary triggering event occurs. In that notice, or in response to a preliminary determination by the Secretary that the institution is not financially responsible based on one or more of those actions or events, the institution could:

• Demonstrate that the reported withdrawal of owner's equity was used exclusively to meet tax liabilities of the institution or its owners for income derived from the institution;

• Show that the mandatory or discretionary event has been resolved, or demonstrate that the institution has insurance that will cover all or part of the liabilities that arise from final judgments or determinations; or

• Provide information about the conditions or circumstances that precipitated that triggering event that demonstrates that the action or event has not or will not have a material adverse effect on the institution.

• Show that the creditor waived a violation of a loan agreement and if applicable, identify any conditions or changes to the loan agreement that the creditor imposed in exchange for granting the waiver.

Finally, the Secretary would consider the information provided by the institution in determining whether to issue a final determination that the

institution is not financially responsible.

Reasons: Under the current process, for the most part, the Department determines annually whether an institution is financially responsible based on its audited financial statements, which are submitted to the Department six to nine months after the end of the institution's fiscal year. Under these proposed regulations, we may determine at the time that certain actions or events occur that the institution is not financially responsible. We address the significance of an action or event that occurs after the close of an audited period (or, in other words, between audit cycles), to assess in a more timely manner whether the institution, regardless of its composite score, satisfies the statutory requirements that it is able to provide the services described in its publications and statements, to provide the administrative resources necessary to comply with title IV, HEA requirements, and to meet all of its financial obligations. In doing so, we propose to expand the range of events that could make an institution not financially responsible, from the provisions under § 668.171(b)(3) relating to whether an institution is current in its debt payments, to other events that may pose a material adverse risk to the financial viability of the institution. In cases where the Department determines that an event poses a material adverse risk, this approach would enable us to address that risk contemporaneously by taking the steps necessary to protect the Federal interest.

Mandatory Triggering Events

With regard to liabilities arising from defenses to repayment discharges adjudicated by the Secretary or an administrative or judicial action or proceeding initiated by a Federal or State entity, we would assess the risk by determining whether the payment of those liabilities would cause the institution's composite score to fall below 1.0. As noted above, the actual amount of the liability would be treated as an expense and the Department would recalculate the institution's most recent composite score using that amount. Assuming that an institution's composite score is 1.0 or higher, if its recalculated composite score does not fall below 1.0, we would conclude that the institution has the resources to pay those liabilities and continue operations. In cases where the institution's recalculated score is less than 1.0, we would conclude that the payment of those liabilities would have a material adverse effect on its operations that warrants additional oversight and financial protection.

During negotiated rulemaking, several non-Federal negotiators argued that including liabilities arising from judicial or administrative actions initiated by a Federal or State entity may cause small or not material changes from an accounting perspective, and reporting those liabilities to the Department would be burdensome and of little value. They suggested that an institution should report only those liabilities that are material, as determined by the institution or its accountant. While we agree that reporting all liabilities from actions resulting in final judgments or determinations may not be necessary, we are concerned that the subjective nature of materiality evaluations could result in an institution not reporting an otherwise significant action. We believe that a better, more objective, approach would be to evaluate the impact of the liability on the institution's composite score, regardless of the amount or materiality of the liability.

The withdrawal of owner's equity is currently an event that an institution reports to the Department under the provisions of the zone alternative in § 668.175(d). An institution participates under the zone alternative if its composite score is between 1.0 and 1.5. We proposed at negotiated rulemaking to relocate this provision to the general standards of financial responsibility under § 668.171. Under those general standards, this provision would still be a reportable event, but only in cases where an institution's financial condition is already precarious and any withdrawal of funds from the institution would further jeopardize its ability to continue as a going concern. In this NPRM, we propose to account for the withdrawal of owner's equity by decreasing adjusted equity and modified equity in recalculating the institution's composite score. Doing so would enable the Department to quantify objectively the impact of the withdrawal.

For publicly-traded institutions, we believe that the SEC or stock exchange-related issues listed in the proposed regulations are actions which would jeopardize the institution's ability to meet its financial obligations or continue as a going concern.

When the SEC suspends trading on the institution's stock, the SEC does not make this warning public or announce that it is considering a suspension until it determines that the suspension is required to protect investors and the public interest.[4] In that event, the SEC posts the suspension and the grounds for the suspension on its website. Therefore, under the reporting requirements in proposed § 668.171(e), the institution would be required to notify the Department within 10 days of receiving notification from the SEC that the institution is being suspended. The SEC may decide to, for example, suspend trading on the institution's stock based on (1) a lack of current, accurate, or adequate information about the institution, for example when the institution is not current in filing its periodic reports; (2) questions about the accuracy of publicly available information, including information in institutional press releases and reports and information about the institution's current operational status, financial condition, or business transactions; or (3) questions about trading in the stock, including trading by insiders, potential market manipulation, and the ability to clear and settle transactions in the stock.[5] Because an action by the SEC to suspend trading in, or delist, an institution's stock directly impairs an institution's ability to raise funds—creditors may call in loans or the institution's credit rating may be downgraded—the Department needs to be informed of those actions in a timely manner.

With regard to compliance with stock exchange requirements, the major exchanges typically require institutions whose stock is listed to satisfy certain minimum requirements such as stock price, number of shareholders, and the level of shareholder's equity.[6] Among other things, if a stock falls below the minimum price, the institution fails to provide timely reports of its performance and operations in its Form 10–Q or 10–K filings with the SEC, or other requirements are not met, the exchange may delist the institution's stock. Delisting is generally regarded as the first step toward a Chapter 11 bankruptcy. However, before the exchange initiates a process to delist the stock, the exchange notifies the institution and may, as applicable, give the institution several days to respond

[4] See SEC Investor Bulletin: Trading Suspensions, available at *www.sec.gov/answers/tradingsuspension.htm.*

[5] Id.

[6] See, *e.g.,* New York Stock Exchange Rule 801.00:

Suspension and Delisting: Securities admitted to the list may be suspended from dealings or removed from the list at any time that a company falls below certain quantitative and qualitative continued listing criteria. When a company falls below any criterion, the Exchange will review the appropriateness of continued listing.

Available at *nysemanual.nyse.com/lcm/sections/lcmsections/chp_1_9/default.asp.*

with a plan of the actions it intends to take to come into compliance with exchange requirements.

With respect to an institution's failure to timely file a required annual or quarterly report with the SEC, we noted previously in this discussion that the late filing of, or failure to file, a required SEC report may precipitate an adverse action by the SEC or a stock exchange. Or, a late filing may limit the institution's ability to conduct certain types of registered securities offerings. In addition, capital markets tend to react negatively in response to late filings. All told, the consequences of late SEC filing may impact the institution's capital position and its financial responsibility for title IV purposes.

With regard to the proposed provision regarding an institution that voluntarily delists its stock; we note that this action would typically relate to a change in ownership that would be subject to Department review. However, even if that action does not trigger a change in ownership, we believe the shift from equity to private financing is a significant event warranting review.

Discretionary Triggering Events

During negotiated rulemaking, the Department proposed several actions or events, all of which were discretionary, that would likely have a material adverse effect on an institution's financial condition. Some of the non-Federal negotiators noted that the 2016 final regulations contained a wider range of triggering events, some mandatory and some discretionary, and urged the Department to adopt that framework and those triggering events in this NPRM to better protect taxpayers. As previously discussed, we are proposing in this NPRM only mandatory triggering events whose consequences are known and quantified (*e.g.,* the actual liabilities incurred from defense to repayment discharge) and objectively assessed through the composite score methodology, or whose consequences pose a severe and imminent risk (*e.g.,* SEC or stock exchange actions) to the Federal interest that warrant financial protection.

This approach differs from that in the 2016 final regulations. Those regulations included as mandatory triggering events (1) events whose consequences were speculative (*e.g.,* estimating the dollar value of a pending lawsuit or pending defense to repayment claims, or evaluating the effects of fluctuations in title IV funding levels), (2) events more suited to accreditor action or increased oversight by the Department (*e.g.,* high drop-out rates and unspecified State violations that may have no bearing on an institution's financial condition or ability to operate in the State), and (3) results of a test (*e.g.,* a financial stress test) whose future development and application was unspecified. Upon further review, we believe these triggering events are inappropriate and would have unnecessarily required institutions to provide a letter of credit or other financial protection. But we propose to include some of the 2016 triggers as discretionary events- certain accrediting agency actions, violations of loan agreements, State licensure and authorization violations, and high cohort default rates. We are also proposing to rescind the mandatory triggering event provisions of the 2016 final regulations.

When an accrediting agency issues an institutional accreditation show-cause order, such action may call into question the institution's continued ability to operate as an accredited institution. As a discretionary trigger, we would work with the institution and the accreditor to determine whether that action has or will have a material adverse effect on the institution's condition or its ability to continue as a going concern before determining whether the institution is financially responsible.

The Department also intends to modify the provisions currently in § 668.171(b)(3) to address violations of loan agreements as a discretionary triggering event. That section currently provides that an institution is not current in debt payments if a loan agreement violation is noted in its audited financial statements or it is more than 120 days delinquent in making a payment and a creditor has filed suit. The Department intends to replace that rule with a discretionary trigger that looks more holistically at the nature and outcome of loan violations. Doing so removes the constraints of relying on disclosures in annual audits or the filing of a lawsuit, and is more in keeping with our goal of assessing potential financial issues contemporaneously. As noted in the proposed provision, a violation of a loan agreement can precipitate a number of consequences that may have a material adverse effect on an institution's ability to meet its financial obligations. For example, the creditor may decide to waive the violation entirely or waive it in exchange for other concessions. In any case, as a discretionary trigger, the Department would work with the institution to determine whether the violation has or could have material financial consequences before determining whether the institution is financially responsible.

The Department similarly plans a more targeted approach to violations of State authorization or licensing requirements. Unlike the 2016 final regulations where an institution would report to the Department any violation of a State authorization or licensing requirement, we propose to consider only those violations that, if unresolved, could lead to termination of the institution's ability to continue to provide educational programs or otherwise continue to operate in the State. Therefore, we propose to rescind these mandatory reporting provisions of the 2016 final regulations.

The Department also proposes to treat the 90/10 revenue requirement as a discretionary triggering event. A proprietary institution that fails the requirement for one fiscal year is in danger of losing its eligibility to participate in the title IV, HEA programs if it fails again in the subsequent fiscal year. Along the same lines, an institution whose cohort default rate is 30% or more for two consecutive years is in danger of losing its title IV loan eligibility if its default rate is 30% or more in the subsequent year. In either case, that risk of lost eligibility may require the Department to seek financial protection from the institution. While the 2016 final regulations would have required an affected institution to provide a letter of credit or other financial protection immediately, the Department believes it is more appropriate for the Department to review the institution's efforts to remedy or mitigate the reasons for its failure, to evaluate the institution's potential and plan to teach-out students if closure appears inevitable, and to assess the extent to which there were anomalous or mitigating circumstances leading to its failure, before determining whether the institution is financially responsible.

In response to requests by the non-Federal negotiators that a process be created to allow an institution to provide information about an action or event to the Department before the Department issues a final determination, we suggested such a process during the negotiations and propose that same process in these regulations. Under that process, an institution has the opportunity to provide information for reportable events twice—once when it notifies the Department that the event occurred and then, if it has additional information, whenever the Department makes a preliminary determination that the event would have a material adverse impact on the institution. For the

reporting requirements in proposed paragraph (f), we adopt the timeframe currently in § 668.28 for notifying the Department of 90/10 failures. For all other events addressed in these proposed regulations, we believe 10 days provides sufficient time for institutions to report those events and for the Department to take action, if needed.

Financial Ratios (§ 668.172)

Statute: Section 498(c)(1) of the HEA authorizes the Secretary to establish ratios and other criteria for determining whether an institution has the financial responsibility required to (1) provide the services described in its official publications; (2) provide the administrative resources necessary to comply with title IV, HEA requirements; and (3) meet all of its financial obligations, including but not limited to refunds of institutional charges and repayments to the Secretary for liabilities and debts incurred for programs administered by the Secretary.

Current Regulations: Section 668.172 defines the Primary Reserve, Equity, and Net Income ratios that comprise the composite score and Appendices A and B illustrate how the composite score is calculated using sample financial statements from proprietary and private non-profit institutions.

Proposed Changes: The Secretary proposes to calculate a composite score in accordance with new standards issued by the Financial Standards Accounting Board (FASB) in Accounting Standards Update (ASU) 2016–02, ASC 842 (Leases). However, the Department will need to update the composite score calculation to take into account this dramatic change in FASB standards, which it cannot do immediately. As a result, for 6 years following the implementation of the new FASB standards, or following the publication of new composite score formula regulations to take into account the FASB change, whichever is shorter, institutions that fail the composite score based on the new FASB standards, but would have had a passing composite score under the former FASB standards (with regard to leases), may request the calculation of an alternative composite score based on additional data provided by the institution to the Department to enable it to calculate an alternative composite score excluding operating leases. The Department will use the higher of those two composite scores to determine whether the institution is financially responsible.

Reasons: The new FASB reporting requirements could negatively impact an institution's composite score even though the underlying financial condition of the institution has not changed. Based on changes FASB announced in February, 2016 in ASU–2016–2, operating leases longer than 12 months will be recorded under GAAP as separate liabilities and right-of-use assets. Consequently, adding operating leases to the Balance Sheet (for proprietary institutions) or to the Statement of Financial Position (for non-profit institutions) could decrease the Equity Ratio if the right-of-use assets in the Modified Assets category significantly increased compared to Modified Equity or Modified Net Assets, resulting in a lower composite score. With that in mind, some of the non-Federal negotiators argued that, due to the long-term nature of some leases, the Department should allow an institution some time to change its business model regarding leases before applying the new FASB standards to its existing leases for purposes of calculating the composite score. We agreed, and in the final session of negotiated rulemaking proposed a six year transition period during which existing leases would be treated under the previous FASB guidance.

However, upon further review, we believe that a transition period would only partially defer and not adequately address the consequences of the accounting changes and how those changes are reflected in the composite score. While we recognize that schools must adhere to the new FASB reporting requirements, which will be reflected in their audited statements, we believe that including assets and liabilities associated with those transactions in the composite score, where no lease-related assets or liabilities are currently included, could encourage some institutions to make changes in their business model that have negative consequences for students. To mitigate a negative impact of the new lease reporting requirements on their composite score, institutions may enter into shorter term but higher cost leases instead of continuing in or entering into longer term leases which typically have better terms, such as lower monthly lease rates and more cost-effective lease improvements. Shorter, more expensive leases may raise costs for institutions, and therefore students, and could result in more frequent campus relocations or closures that may interfere with students' ability to complete their programs and raise the risk to taxpayers of increased numbers of closed school student loan discharges. We believe that it is undesirable to put an institution in a position where it could incur increased costs from short-term leases or where the institution would have to relocate or close because it could not negotiate or renew a favorable lease agreement without jeopardizing its composite score. In some instances, even if the school is able to relocate to another comparable facility, the State authorizing body or the accreditor may not approve that relocation if the new facility is more than a certain geographic distance or travel time away from the original campus, if it is on a different public transportation line or if it lacks comparable access via public transportation. In such a case, the campus move is treated as a campus closure, which requires the institution to either teach-out the closing campus or suffer the financial losses associated with closed school loan discharges. The higher costs of short-term leases or relocation costs, or both, would likely be passed on to students. Unfortunately, the composite score currently has no mechanism for automatic updates in the event of changes in accounting standards.

For these reasons, and because the impact of the upcoming FASB lease requirements is unknown, we believe it is necessary to update the composite score regulations to take into account this and other FASB changes. Future negotiated rulemaking will be required to update the composite score regulations, so until such time as revised composite score regulations are established, or for six years after implementation of the new FASB standards (for leases), the Department will allow institutions the option to continue calculating the composite score under current GAAP standards. Therefore, the Department proposes an approach under which we will calculate a composite score for all institutions under the new FASB requirements when they take effect since all audited financial statements will be based on the new requirements, but we will allow institutions to provide additional data to support the calculation of an alternative composite score under current GAAP standards (GAAP prior ASU–2016–2 implementation), and in such a case, to use the higher of the two composite scores to evaluate financial responsibility, for the next six years or until revised composite score regulations are promulgated, which ever period is shortest.

Appendix A to Subpart L, Part 668

Statute: Section 498(c)(1) of the HEA authorizes the Secretary to establish ratios and other criteria for determining whether an institution has the financial responsibility required to (1) provide

the services described in its official publications, (2) provide the administrative resources necessary to comply with title IV, HEA requirements, and (3) meet all of its financial obligations, including but not limited to refunds of institutional charges and repayments to the Secretary for liabilities and debts incurred for programs administered by the Secretary.

Current Regulations: As provided under § 668.172(a), appendix A to subpart L contains three sections that illustrate how the composite score is calculated for a proprietary institution. Section 1 sets forth the ratios and defines the ratio terms. Section 2 provides a model Balance Sheet and Statement of Income and Retained Earnings with numbered line entries and shows the numbered entries that are used to calculate each of the financial ratios. Section 3 takes the calculated ratios from Section 2 and applies strength factors and weights associated with each ratio to derive a blended, or composite, score that the Secretary uses to determine, in part, whether the institution is financially responsible.

Proposed Changes: The Secretary proposes revising these three sections by amending the first section to reflect changes in accounting standards and to make other clarifying changes that the Secretary believes will improve compliance with the financial responsibility standards. We propose to add a new section 2 that would provide a Supplemental Schedule which schools would be required to provide as part of their annual financial statement audit submission. Proposed section 2 would be titled, ''Section 2: Financial Responsibility Supplemental Schedule Requirement and Example.'' Proposed Section 3 would combine sections 2 and 3 from the current regulations, and would be titled, ''Example Financial Statements and Composite Score Calculation.''

Appendix A, Section 1

For a proprietary institution, the Secretary proposes to revise the numerator, Adjusted Equity, and the denominator, Total Expenses, of the Primary Reserve Ratio.

Changes to Adjusted Equity:

As currently defined, Adjusted Equity includes ''post-employment and retirement liabilities'' and ''all debt obtained for long-term purposes.'' The Secretary proposes changing these terms to ''post-employment and defined benefit pension liabilities'' and ''all debt obtained for long-term purposes, not to exceed property, plant and equipment (PP&E),'' respectively. In addition, the Secretary proposes to clarify the term ''unsecured related party receivables'' by referencing the related entity disclosure requirements under § 668.23(d). With regard to determining the value of PP&E, which is currently the amount net of accumulated depreciation, the Secretary proposes to include construction in progress and lease right-of-use assets.

As noted above, we propose to amend the current definition of ''debt obtained for long-term purposes'', which currently includes the short-term portion of the debt, up to the amount of PP&E. Specifically, we are proposing to change the meaning of the term ''debt obtained for long-term purposes'', to include lease liabilities for lease right-of-use assets and the short-term portion of the debt, up to the amount of net PP&E. However, if an institution wishes to include the debt as part of the total debt obtained for long-term purposes, including debt obtained through long-term lines of credit, the institution would have to provide a disclosure in the financial statements that the debt, including lines of credit, exceeds twelve months and was used to fund capitalized assets (*i.e.,* PP&E or capitalized expenditures per Generally Accepted Accounting Principles (GAAP)). The disclosure for the debt would include the issue date, term, nature of capitalized amounts and amounts capitalized. The debt obtained for long-term purposes would be limited to those amounts disclosed in the financial statements that were used to fund capitalized assets. Any other debt amount, including long-term lines of credit used to fund operations, would be excluded from debt obtained for long-term purposes.

Changes to Total Expenses:

Currently, the regulations provide that the term ''Total Expenses'' excludes income tax, discontinued operations, extraordinary losses or change in accounting principle. The Department proposes to change that term to ''Total Expenses and Losses'' and define the proposed term as: All expenses and losses, (excludes income tax, discontinued operations not classified as an operating expense or change in accounting principle), less any losses on investments, post-employment and defined benefit pension plans and annuities. Any losses on investments would be the net loss for the investments and Total Expenses and Losses would include the nonservice component of net periodic pension and other post-employment plan expenses.

Net Income Ratio

The Department proposes to modify the numerator of the Net Income ratio, ''Income before Taxes,'' and the denominator, ''Total Revenues.''

Currently, ''Income before Taxes'' is taken directly from the institution's audited financial statements. The Department proposes to define ''Income before Taxes'' to include all revenues, gains, expenses and losses incurred by the institution during the accounting period. Income before taxes would not include income taxes, discontinued operations not classified as an operating expense or changes in accounting principle.

With regard to the denominator, we propose to change the term ''Total Revenues'' to ''Total Revenues and Gains.''

We note that while the current regulations define the term ''Total Pretax Revenues'' (total operating revenues + non-operating revenues and gains, where investments gains should be recorded net of investment losses), that term was erroneously published and we should have used the term Total Revenues. The Secretary proposes to correct that error and define the term, ''Total Revenues and Gains'' as all revenues and gains not including positive income tax amounts, discontinued operations not classified as an operating gain, or change in accounting principle (investment gains would be recorded net of investment losses).

Reasons: The proposed changes are intended to reflect current accounting standards, particularly Accounting Standards Update (ASU) 2016–2 Leases (Topic 842), and clarify how the composite score is calculated.

When implemented, ASU 2016–2 will require all non-profit and proprietary institutions to recognize the assets and liabilities that arise from leases. In accordance with FASB Concepts Statement No. 6, Elements of Financial Statements, all leases create an asset and a liability as of the date of the Statement of Financial Position, or Balance Sheet, and therefore, an institution must recognize those lease assets and lease liabilities as of that date. This is a change compared to the previous GAAP approach, which did not require lease assets and lease liabilities to be recognized for most leases.

Under this ASU, a proprietary institution is required to recognize in its Balance Sheet a liability for the value of the lease agreement (the lease liability) and a right-of-use asset representing its right to use the underlying asset for lease terms longer than one fiscal year. The principal difference from previous accounting guidance is that the lease assets and lease liabilities arising from

operating leases will now be recognized in the Balance Sheet.

The Subcommittee asked the Department to consider including defined benefit pension plan liabilities as a retirement liability that would be added back to Adjusted Equity. The Subcommittee stated that changes in accounting practice that now require defined pension plan liabilities to be on the face of the financial statements, as well as, the required insurance for pension liabilities and the timing of when the liability would be payable, all indicate that defined benefit plan liabilities should not reduce Adjusted Equity. In addition, the Subcommittee argued that all other retirement liabilities are already included in post-employment liabilities and rather than having post-employment and retirement liabilities for expendable net assets it would be clearer to the community to use post-employment and defined benefit pension plan liabilities. The Department agreed that the Subcommittee proposals would clarify how defined benefit pension plan liabilities will be treated for purposes of Adjusted Equity.

In the preamble to the notification of final regulations published in the **Federal Register** on November 25, 1997 (62 FR 62867) (1997 Regulations), the Department was clear that the expenses included in the Primary Reserve Ratio included losses; however the appendix did not include language concerning losses. Since the inception of the composite score as a measure of a school's financial health, the Department has included losses as part of the denominator for the Primary Reserve Ratio. The proposed changes to the denominator for the Primary Reserve Ratio reflect changes in the accounting terminology and clarify what has consistently been the Department's practice. With regard to losses, the Subcommittee suggested that there were some losses that should not be reflected in the Primary Reserve Ratio. The Subcommittee proposed that the Primary Reserve Ratio not include any losses from post-employment and defined benefit pension plans and annuities. The Department agreed.

As a result of ASU 2016–2, the Department proposes including the right-of-use asset from leases as part of PP&E (which is a component of Adjusted Equity in the Primary Reserve ratio). The Subcommittee recommended that the Department include construction in progress in PP&E for the purpose of calculating the Primary Reserve ratio. The Subcommittee members pointed out that by its very nature, construction in progress could not be considered an expendable asset because it cannot be easily converted to cash or cash equivalents when an institution is in financial difficulty. The Department agreed and proposes here to include construction in progress with PP&E.

Initially, the Subcommittee's discussion about how to treat debt obtained for long-term purposes in calculating the composite score, focused around the change in accounting for leases under ASU 2016–2. Under ASU 2016–2 the liability for leases is not considered debt for accounting purposes. The Subcommittee noted that although the lease liability was not debt, the liability was clearly associated with PP&E and argued that it should be included as debt obtained for long-term purposes for the composite score. This discussion then expanded to consider the various types of debt and liabilities that the Department encounters in evaluating financial statements and computing the composite score. In 2017, both the Government Accountability Office (GAO) and the Department's Office of Inspector General (OIG) issued audit reports that found that the Department was not doing enough to limit manipulation of the composite score to protect students from institutions that could be in danger of financial difficulty (''Education Should Address Oversight and Communication Gaps in Its Monitoring of the Financial Condition of Schools'' (GAO–17–555) [7] and ''Federal Student Aid's Processes for Identifying At-Risk Title IV Schools and Mitigating Potential Harm to Students and Taxpayers'' (ED–OIG A09Q0001) [8]). The Department is aware that some institutions use debt, including long-term lines of credit, to improve their composite scores without actually using the debt for long-term purposes. The use of debt to improve the composite score, including long-term lines of credit, can be difficult to identify from examining an institution's audited financial statements. When the composite score was originally developed, the Department's intention was that the long-term debt would be added back for purposes of the calculation of the expendable net assets was the amount of debt that was used for the purchase of capitalized assets. We question the viability of an institution that uses debt, including long-term lines of credit, for current operations as opposed to long-term purposes. Consequently, the amount of long-term debt that is added back for expendable net assets should have some relationship to PP&E—and therefore should not be included in debt obtained for long-term purposes if it is not used for the purchase of capitalized assets.

The Subcommittee specifically discussed the treatment of long-term lines of credit with regard to debt obtained for long-term purposes and agreed with the Department's proposed treatment of long-term lines of credit. The Department proposes extending this treatment to all debt not used for long-term purposes to further reduce or mitigate manipulation of the composite score.

In the preamble to the 1997 Regulations, the Department was clear that the calculation of expenses for the Primary Reserve Ratio included losses; however, the Appendices to subpart L did not include language concerning losses. Since the inception of the composite score, the Department has included losses as part of the denominator for the Primary Reserve Ratio. The proposed changes to the denominator for the Primary Reserve Ratio reflect changes in the accounting terminology and clarify what has consistently been the Department's practice. With regard to losses, the Subcommittee suggested that there were some losses that should not be reflected in the Primary Reserve Ratio. The Subcommittee proposed that the Primary Reserve Ratio should not include any losses on investments, post-employment and defined benefit pension plans and annuities. The Department agreed and has reflected this change in the proposed regulations.

The Department proposes to add a reference to the disclosure requirement for unsecured related party transactions under § 668.23(d). For both proprietary and non-profit schools, related party receivables or other related assets are excluded from the composite score calculation if the amount is not secured and perfected at the date of the financial statements. The Related Party disclosure should provide enough detail about the relationship, transaction(s) and any conditions for the Department to be able to make a determination on whether the related party receivable or other related assets are properly secured for inclusion in the composite score calculation.

Appendices A and B, Section 2

Proposed changes: Under proposed Section 2 for appendices A and B, proprietary and non-profit institutions would be required to submit a Supplemental Schedule as part of their audited financial statements. The Supplemental Schedule would contain

[7] Available at: *www.gao.gov/products/GAO-17-555.*

[8] Available at: *www2.ed.gov/about/offices/list/oig/auditreports/fy2017/a09q0001.pdf.*

all of the financial elements required to calculate the composite score and a corresponding or related reference to the Statement of Financial Position, Statement of Activities, Schedule of Natural to Functional Expenses, Balance Sheet, Income Statement, or Notes to the Financial Statements. The amount entered in the Supplemental Schedule for each element would tie directly to a line item, be part of a line item, tie directly to a note, or be part of a note in the financial statements. In addition, the audit opinion letter would contain a paragraph referencing the auditor's additional analysis of the *Supplemental Schedule.*

Reasons: As a result of the FASB updates, some elements needed to calculate the composite score would no longer be readily available in the audited financial statements, particularly for non-profit institutions. The Subcommittee suggested using a Supplemental Schedule as a means to address this issue. Moreover, by referencing the financial statements, the Supplemental Schedule would increase transparency in how the composite score is calculated for both institutions and the Department. The Subcommittee requested and received advice from auditors and accountants that the burden stemming from the Supplemental Schedule would be minimal. The Subcommittee believed, and we agree, that any burden is outweighed by the need for the information and the increase in transparency.

Appendices A and B, Section 3

Proposed changes: Proposed Section 3 would combine, conceptually, Sections 2 and 3 of the current appendices. While we do not propose to modify the current strength factors and weights for each, proposed Section 3 would be updated to reflect changes in terminology based on the changes in accounting standards and modifications to the item amounts used in the example financial statements.

Reasons: We propose to revise current Section 3 of appendices A and B to conform with the proposed changes to Sections 1 and 2 of those appendices.

Appendix B to Subpart L, Section 1

Statute: Section 498(c)(1) of the HEA authorizes the Secretary to establish ratios and other criteria for determining whether an institution has the financial responsibility required to (1) provide the services described in its official publications, (2) provide the administrative resources necessary to comply with title IV, HEA requirements, and (3) meet all of its financial obligations, including but not limited to refunds of institutional charges and repayments to the Secretary for liabilities and debts incurred in programs administered by the Secretary.

Current Regulations: Appendix B to subpart L contains three sections that illustrate how the composite score is calculated for a non-profit institution. Specifically, Section 1 sets forth the ratios and defines the ratio terms. Section 2 provides a model Statement of Activities and Balance Sheet with numbered line entries and shows the numbered entries that are used to calculate each of the financial ratios. Section 3 takes the calculated ratios from Section 2 and applies strength factors and weights associated with each ratio to derive a blended, or composite, score that the Secretary uses to determine, in part, whether the institution is financially responsible.

Proposed Changes: We propose to revise appendix B by amending the definitions of terms used in Section 1 to reflect changes in accounting standards and other changes that the Secretary believes would clarify how the composite score is calculated. We previously noted in the discussion for appendix A the proposed changes to Sections 2 and 3 of appendix B.

Appendix B, Section 1

The Department proposes to modify the definition of the terms ''Expendable Net Assets'' and ''Total Expenses'' as those terms are used in calculating the Primary Reserve Ratio. Under the current regulations, the ''Expendable Net Assets'' are:

(unrestricted net assets) + (temporarily restricted net assets) – (annuities, term endowments and life income funds that are temporarily restricted) – (intangible assets) – (net property, plant and equipment) * + (post-employment and retirement liabilities) + (all debt obtained for long-term purposes) ** – (unsecured related-party receivables).

*The value of property, plant and equipment is net of accumulated appreciation, including capitalized lease assets.

** The value of all debt obtained for long-term purposes includes the short-term portion of the debt, up to the amount of net property, plant and equipment.

The Department proposes to revise the definition of ''Expendable Net Assets'' to be:

(Net assets without donor restrictions) + (net assets with donor restrictions) – (net assets with donor restrictions: Restricted in perpetuity) * – (annuities, term endowments and life income funds with donor restrictions) ** – (intangible assets) – (net property, plant and equipment) *** + (post-employment and defined benefits pension plan liabilities) + (all long-term debt obtained for long-term purposes, not to exceed total net property, plant and equipment) **** – (unsecured related party transactions) *****.

* Net assets with donor restrictions: Restricted in perpetuity is subtracted from total net assets. The amount of net assets with donor restrictions: Restricted in perpetuity is disclosed as a line item, part of line item, in a note, or part of a note in the financial statements.

** Annuities, term endowments and life income funds with donor restrictions are subtracted from total net assets. The amount of annuities, term endowments and life income funds with donor restrictions is disclosed in as a line item, part of line item, in a note, or part of a note in the financial statements.

*** The value of property, plant and equipment includes construction in progress and lease right-of-use assets and is net of accumulated depreciation/amortization.

**** All Debt obtained for long-term purposes, not to exceed total net property, plant and equipment includes lease liabilities for lease right-of-use assets and the short-term portion of the debt, up to the amount of net property, plant and equipment. If an institution wishes to include the debt, including debt obtained through long-term lines of credit in total debt obtained for long-term purposes, the institution must include a disclosure in the financial statements that the debt, including lines of credit exceeds twelve months and was used to fund capitalized assets (*i.e.,* property, plant and equipment or capitalized expenditures per Generally Accepted Accounting Principles (GAAP)). The disclosures that must be presented for any debt to be included in expendable net assets include the issue date, term, nature of capitalized amounts and amounts capitalized. Institutions that do not include debt in total debt obtained for long-term purposes, including long-term lines of credit, do not need to provide any additional disclosures other than those required by GAAP. The debt obtained for long-term purposes will be limited to only those amounts disclosed in the financial statements that were used to fund capitalized assets. Any debt amount including long-term lines of credit used to fund operations must be excluded from debt obtained for long-term purposes.

***** Unsecured related party receivables as required at 34 CFR 668.23(d).

Under the current regulations, the term ''Total Expenses'' is defined as ''Total unrestricted expenses taken directly from the audited financial statements.'' We propose to change the term to ''Total Expenses without Donor Restrictions and Losses without Donor Restrictions.'' In addition, the Department proposes to define the new term ''Total Expenses without Donor Restrictions and Losses without Donor Restrictions'' as all expenses and losses without donor restrictions from the Statement of Activities less any losses

without donor restrictions on investments, post-employment and defined benefit pension plans, and annuities. (For institutions that have defined benefit pension and other post-employment plans, total expenses include the nonservice component of net periodic pension and other post-employment plan expenses and these expenses will be classified as non-operating. Consequently such expenses will be labeled non-operating or included with ''other changes – non-operating changes in net assets without donor restrictions'' when the Statement of Activities includes an operating measure).

The numerator of the Equity Ratio, Modified Net Assets, is currently defined as ''(total assets) – (intangible assets) – (unsecured related-party receivables).'' We propose to change the definition of Modified Net Assets to ''(net assets without donor restrictions) + (net assets with donor restrictions) – (intangible assets) – (unsecured related party receivables)''.

For the Net Income Ratio, the current regulations specify that the amounts for both the numerator, ''Change in Unrestricted Net Assets,'' and the denominator, ''Total Unrestricted Revenue'', are taken directly from the audited financial statements. We propose to rename the numerator as ''Change in Net Assets without Donor Restrictions,'' and the denominator as ''Total Revenue without Donor Restriction and Gains without Donor Restrictions.'' In addition, the Department proposes that the denominator, Total Revenue, would include amounts released from restriction plus total gains. The Department notes that with regard to gains, investment returns are reported as a net amount (interest, dividends, unrealized and realized gains and losses net of external and direct internal investment expense). Institutions that separately report investment spending as operating revenue (*e.g.* spending from funds functioning as endowment) and remaining net investment return as a non-operating item, will need to aggregate these two amounts to determine if there is a net investment gain or a net investment loss (net investment gains are included with total gains).

Reasons: The proposed changes are intended to reflect current accounting standards and clarify how the composite score is calculated. Many of the proposed changes stem from significant changes to the accounting standards, primarily ASU 2016–2 Leases (Topic 842) and 2016–14 Not-for-Profit Entities (Topic 958), ASU 2016–2 and ASU 2016–14 respectively.

When implemented, ASU 2016–2 will require all non-profit and proprietary institutions to recognize the assets and liabilities that arise from leases. In accordance with FASB Concepts Statement No. 6, Elements of Financial Statements, all leases create an asset and a liability as of the Statement of Financial Position, or Balance Sheet, date and, therefore, an institution must recognize those lease assets and lease liabilities as of that date.

A non-profit institution must recognize in the Statement of Financial Position a liability for the value of the lease agreement (the lease liability) and a right-of-use asset representing its right to use the underlying asset for the lease term. The principal difference from previous guidance is that the lease assets and lease liabilities arising from operating leases should be recognized in the Statement of Financial Position.

Under ASU 2016–14, a non-profit institution must present on the face of the Statement of Financial Position amounts for two classes of net assets at the end of the period, rather than for the currently required three classes. That is, the institution will report amounts for net assets with donor restrictions and net assets without donor restrictions, as well as the currently required amount for total net assets. Temporarily restricted net assets, which were previously reported, will be eliminated as a class of net assets. A non-profit institution must also present on the face of the Statement of Activities the amount of the change in each of the two classes of net assets rather than the currently required three net asset classes, as well as report the currently required amount of the change in total net assets for the period. These changes were made as a result of complexities arising from using the three classes of net assets which focus on the absence or presence of donor imposed restrictions and whether those restrictions are temporary or permanent.

ASU 2016–14 eliminated the use of the term ''temporarily restricted net assets'' because of difficulties with classifying assets as temporarily restricted. On its face, under this ASU, assets with donor restrictions would not be considered expendable net assets. In discussions with the Subcommittee, the Department agreed that there are some elements of assets with donor restrictions that could be considered expendable. An example of this would be an endowment where the corpus is permanently restricted by the donor, but the earnings from the endowment can be used to pay salaries. The Subcommittee put forward that the primary element of assets with donor restrictions that is not expendable is ''net assets with donor restrictions: restricted in perpetuity.'' Subtracting ''net assets with donor restrictions: restricted in perpetuity'' from net assets with donor restrictions plus net assets without donor restrictions roughly approximates the amount that would have been included in the composite score using unrestricted net assets and temporarily restricted net assets. Likewise, using the amounts from annuities, term endowments and life income funds with donor restrictions, approximates the amount of annuities, term endowments and life income funds that are temporarily restricted that would have been used prior to the proposed change.

The Subcommittee asked the Department to consider including defined benefit pension plan liabilities as a retirement liability that would be added back to expendable net assets. The Subcommittee stated that changes in accounting practice that now require defined pension plan liabilities to be on the face of the financial statements, as well as the required insurance for pension liabilities and the timing of when the liability would be payable, all indicate that defined benefit plan liabilities should not reduce expendable net assets. In addition, the Subcommittee argued that all other retirement liabilities are already included in post-employment liabilities, and rather than having post-employment and retirement liabilities for expendable net assets, it would be clearer to the community to use post-employment and defined benefit pension plan liabilities. The Department agreed that the Subcommittee proposals would clarify how defined benefit pension plan liabilities will be treated for expendable net assets.

As a result of ASU 2016–2, the Department proposes including the right-of-use asset from leases as part of PP&E (which is a component of Expendable Net Assets in the Primary Reserve ratio). During the general discussions with the Subcommittee about PP&E, the Subcommittee recommended that the Department should include construction in progress in PP&E for purposes of calculating the Primary Reserve ratio. The Subcommittee pointed out that by its very nature, construction in progress could not be considered an expendable asset because it cannot be easily converted to cash or cash equivalents when an institution is in financial difficulty. The Department agreed and

proposes here to include construction in progress with PP&E.

Initially, the discussion in the Subcommittee surrounding how to treat debt obtained for long-term purposes in calculating the composite score, focused around the change in accounting for leases under ASU 2016–2. Under ASU 2016–2 the liability for leases is not considered debt for accounting purposes. The Subcommittee noted that although the lease liability was not debt, the liability was clearly associated with PP&E and argued that it should be included as debt obtained for long-term purposes in the composite score calculation. This discussion then expanded to consider the various types of debt and liabilities that the Department encounters in evaluating financial statements and computing the composite score. As noted above, in 2017, both GAO and OIG issued audit reports that found that the Department was not doing enough to limit manipulation of the composite score to protect students from institutions that could be in danger of financial difficulty. The Department is aware that some institutions use debt, including long-term lines of credit, to improve their composite scores without actually using the debt for long-term purposes. The use of debt to improve the composite score, including long-term lines of credit, can be difficult to identify from examining an institution's audited financial statements. When the composite score was originally developed, the long-term debt that was intended to be added back for purposes of expendable net assets was the amount of debt that was used for the purchase of capitalized assets. We question the viability of an institution that uses debt, including long-term lines of credit, for current operations as opposed to long-term purposes. Consequently, the amount of long-term debt that is added back for expendable net assets should have some relationship to PP&E—and therefore should not be included in debt obtained for long-term purposes if it is not used for the purchase of capitalized assets.

The Subcommittee specifically discussed the treatment of long-term lines of credit with regard to debt obtained for long-term purposes and agreed with the Department's proposed treatment of long-term lines of credit. The Department proposes extending this treatment to all debt not used for long-term purposes to further reduce or mitigate manipulation of the composite score.

In the preamble to the 1997 Regulations, the Department was clear that expenses for the Primary Reserve Ratio included losses; however, the Appendices to subpart L did not include language concerning losses. Since the inception of the composite score, the Department has included losses as part of the denominator for the Primary Reserve Ratio. The proposed changes to the denominator for the Primary Reserve Ratio reflect changes in the accounting terminology and clarify what has consistently been the Department's practice. With regard to losses, the Subcommittee suggested that there were some losses that should not be reflected in the Primary Reserve Ratio. The Subcommittee proposed that the Primary Reserve Ratio should not include any losses without donor restrictions on investments, post-employment and defined benefit pension plans and annuities. The Department agreed.

All of the proposed changes to the Equity Ratio are based solely on changes in accounting terminology as a result of ASU 2016–14.

The change to the numerator for the Net Income Ratio is based solely on changes in accounting terminology as a result of ASU 2016–14. The proposed changes to the denominator are based on changes in accounting terminology and Department practice concerning gains. In the preamble to the 1997 Regulations, the Department was clear that revenue for the Net Income Ratio included gains; however the Appendices to subpart L did not include language concerning gains. Since the inception of the composite score, the Department has included gains as part of the denominator for the Net Income Ratio.

The Department proposes to add a reference to the regulatory disclosure requirement for unsecured related party transactions under § 668.23(d). While the Department believes that this reference promotes clarity, Subcommittee members representing the non-profit sector expressed concern that certain aspects of related party transactions unique to the non-profit sector required more thorough explanation. The Department agreed, and provides additional information below.

For both proprietary and non-profit institutions, related party receivables or other related assets are excluded from the composite score if the amount is not secured and perfected as of the date of the financial statements. The Related Party disclosure should provide enough detail about the relationship, transaction(s) and any conditions for the Department to be able to make a determination on whether the related party receivable or other related assets are properly secured for inclusion in the composite score.

For non-profit schools, related party contributions receivables from board members would be allowed to be included in secured related party receivables if there was no additional relationship or transactions with the board member or his/her family or related entities and there were no additional conditions associated with the contribution if disclosed in the related party disclosure.

Alternative Standards and Requirements (§ 668.175)

Statute: Section 498(c)(3) of the HEA provides that if an institution fails the composite score or other criteria established by the Secretary to determine whether the institution is financially responsible, the Secretary must determine that the institution is financially responsible if it provides third-party financial guarantees, such as performance bonds or letters of credit payable to the Secretary, for an amount that is not less than one-half of the annual potential liabilities of the institution to the Secretary for title IV, HEA funds, including liabilities for loan obligations discharged pursuant to section 437 of the HEA, and to students for refunds of institutional charges, including required refunds of title IV, HEA funds.

Current Regulations: As provided in § 668.175, an institution that is not financially responsible under the general standards in § 668.171 may begin or continue to participate in the title IV, HEA programs only by qualifying under an alternative standard.

Under the zone alternative in § 668.175(d), a participating institution that is not financially responsible solely because its composite score is less than 1.5 may participate as a financially responsible institution for no more than three consecutive years, but the Secretary requires the institution to (1) make disbursements to students under the heightened cash monitoring or reimbursement payment methods described in § 668.162, and (2) provide timely information regarding any adverse oversight or financial event, including any withdrawal of owner's equity from the institution. In addition, the Secretary may require the institution to (1) submit its financial statement and compliance audits earlier than the date specified in § 668.23(a)(4), or (2) provide information about its current operations and future plans.

Under the provisional certification alternative in § 668.175(f), an institution that is not financially responsible

because it does not meet the general standards in § 668.171(b), or because of an audit opinion in § 668.171(d) or a condition of past performance in § 668.174(a), may participate under a provisional certification for no more than three consecutive years, if the institution (1) provides an irrevocable letter of credit, for an amount determined by the Secretary that is not less than 10 percent of the title IV, HEA program funds the institution received during its most recently completed fiscal year, (2) demonstrates that it was current in its debt payments and has met all of its financial obligations for its two most recent fiscal years, and (3) complies with the provisions under the zone alternative.

Proposed Regulations: We propose to relocate to proposed new § 668.171(c) one of the oversight and financial events that an institution currently reports to the Department under the zone alternative in § 668.175(d)(2)(ii)—any withdrawal of owner's equity from the institution.

We propose to remove § 668.175(e) because the transition year alternative, which pertained only to fiscal years beginning after July 1, 1997 and before June 30, 1998, is no longer relevant.

Also, we propose to add a new paragraph (h) that would expand the types of financial protection the Secretary may accept. Specifically, in lieu of submitting a letter of credit, the Secretary may permit an institution to:

- Provide the amount required in the form of other surety or financial protection that the Secretary specifies in a notice published in the **Federal Register**;
- Provide cash for the amount required; or
- Enter into an arrangement under which the Secretary would offset the amount of title IV, HEA program funds that an institution has earned in a manner that ensures that, no later than the end of a six- to twelve-month period, the amount offset equals the amount of financial protection the institution is required to provide. Under this arrangement, the Secretary would use the funds offset to satisfy the debts and liabilities owed to the Secretary that are not otherwise paid directly by the institution, and would provide to the institution any funds not used for this purpose during the period covered by the agreement, or provide the institution any remaining funds if the institution subsequently submits other financial protection for the amount originally required.

In addition, we propose to amend the zone and provisional certification alternatives under § 668.175(d) and (f), to allow for these expanded types of financial protection.

Reasons: Because the costs of obtaining an irrevocable LOC have increased over time, to the point where financial institutions are not only charging fees but in many cases requiring the LOC to be fully collateralized, we are proposing to allow an institution to provide alternative forms of financial protection that would reduce the costs to an institution. Providing cash would eliminate the cost of fees associated with an LOC and the administrative offset alternative would relieve an institution from any collateralization requirements or from having to commit upfront the resources needed to obtain the required financial protection. However, we note that, to implement an administrative offset, the Department would need to control the title IV funds flowing to the institution and the current process for doing that is to place the institution on the heightened cash monitoring payment method (HCM2) under § 668.162(d)(2). The Secretary would provide funds to the institution under HCM2, but would withhold temporarily a portion of any reimbursement claim payable to the institution in an amount that ensures that by the end of the offset period, the total amount withheld equals the amount of cash or the letter of credit the institution would otherwise provide.

During negotiated rulemaking, we proposed that the offset agreement would have to provide that the entire amount of the financial protection required by the Department would have to be in place within a nine-month period. The non-Federal negotiators argued that the Department should have flexibility in setting the offset period depending on the amount of protection that is needed or the amount of the offset that the institution could reasonably provide on a monthly basis as specified in the agreement. We agreed and propose here the suggestion from the non-Federal negotiators that the total amount offset must be in place within a six- to 12-month period, as determined by the Department.

With regard to other types of surety, we are not aware of any instruments or surety products that would provide the Department with the level of financial protection, or ready access to funds, as an irrevocable letter of credit. However, should such surety products become available that the Department finds acceptable and that are less costly or more readily available to institutions, the Secretary would identify those products in a notice published in the **Federal Register**. After that, an institution could use those products to satisfy the financial protection requirements in these regulations.

Initial and Final Decisions (§ 668.90)

Statute: Section 498(d) of the HEA authorizes the Secretary to consider the past performance of an institution or of a person in control of an institution in determining whether an institution has the financial capability to participate in the title IV, HEA programs. Section 487(c)(1)(F) of the HEA, provides that the Secretary shall prescribe such regulations as may be necessary to provide for the limitation, suspension, or termination of the participation of an eligible institution in any program under title IV of the HEA.

Current Regulations: When the Department proposes to limit, suspend, or terminate a fully certified institution's participation in a title IV, HEA program, the institution is entitled to a hearing before a hearing official under § 668.91. In addition to describing the procedures for issuing initial and final decisions, § 668.91 also provides requirements for hearing officials in making initial and final decisions in specific circumstances.

The regulations generally provide that the hearing official is responsible for determining whether an adverse action—a fine, limitation, suspension, or termination—is ''warranted,'' but direct that, in specific instances, the sanction must be imposed if certain predicate conditions are proven. For instance, in an action involving a failure by the institution to provide a surety in the amount specified by the Secretary under § 668.15, the hearing official is required to consider the surety amount demanded to be ''appropriate,'' unless the institution can demonstrate that the amount was ''unreasonable.''

Further, § 668.91(a)(3)(v) states that, in a termination action brought on the grounds that the institution is not financially responsible under § 668.15(c)(1), the hearing official must find that termination is warranted unless the conditions in § 668.15(d)(4) are met. Section 668.15(c)(1) provides that an institution is not financially responsible if a person with substantial control over that institution exercises or exercised substantial control over another institution or third-party servicer that owes a liability to the Secretary for a violation of any title IV, HEA program requirements, and that liability is not being repaid. Section 668.15(d)(4) provides that the Secretary can nevertheless consider the first institution to be financially responsible if the person at issue has repaid a portion of the liability or the liability is being repaid by others, or the institution

demonstrates that the person at issue in fact currently lacks that ability to control or lacked that ability as to the debtor institution.

Proposed Regulations: The Secretary proposes to amend § 668.91(a)(3)(iii) by substituting the terms ''letter of credit or other financial protection'' for ''surety'' in describing what an institution must provide to demonstrate financial responsibility and adding § 668.171(b),(c), or (d) to the list of sections under which a condition or event may trigger a financial protection requirement. Additionally, we are proposing to modify § 668.91(a)(3)(iii) to require the hearing official to uphold the amount of a letter of credit or financial protection demanded by the Secretary, unless the institution demonstrates that the events or conditions on which the demand is based no longer exist or have been resolved, do not and will not have an material adverse effect on the institution's financial condition, or the institution has insurance that will cover the liabilities arising from those events or conditions. We propose to further modify § 668.91(a)(3)(v) to list the specific circumstances in which a hearing official may find that a termination or limitation action brought for a failure of financial responsibility for an institution's past performance failure under § 668.174(a), or a failure of a past performance condition for persons affiliated with an institution under § 668.174(b)(1), was not warranted. For the former, revised § 668.91(a)(3)(v) would state that these circumstances would be consistent with the provisional certification and financial protection alternative in § 668.175(f). For the latter, the circumstances would be those provided in § 668.174(b)(2).

Reasons: The proposed changes to § 668.91(a)(3)(iii) would update the regulations to reflect both the current language in § 668.175 and proposed changes to that section. We believe that the new language would provide more clarity than the current regulation, which provides only that the institution has to show that the amount was ''unreasonable.'' The proposed language would clearly state that the amount of the letter of credit or other financial protection would be considered unwarranted only if the reasons for which the Secretary required the financial protection no longer exist or have been resolved, do not and will not have an material adverse effect on the institution's financial condition, or the institution has insurance that will cover the liabilities arising from those events or conditions.

Our proposed revisions to § 668.91(a)(3)(iii) would reflect previous, as well as proposed, changes to the financial responsibility standards. First, the current financial responsibility standards in § 668.175 require an institution in some instances to provide a letter of credit to be considered financially responsible. We propose to modify § 668.91(a)(3)(iii) to reflect that language as well as changes proposed to § 668.175 by substituting the terms ''letter of credit or other financial protection'' for ''surety.'' Thus, the proposed changes to § 668.91 would clarify that a limitation, suspension, or termination action may involve a failure to provide any of the specified forms of financial protection.

We further propose to modify § 668.91(a)(3)(iii) to state the specific grounds on which a hearing official may find that a limitation or termination action for failure to provide financial protection demanded is not warranted. Under the proposed regulations, the hearing official must accept the amount of the letter of credit or financial protection demanded by the Secretary, unless the institution demonstrates that the events or conditions on which the demand for financial protection or letter of credit is based no longer exist or have been resolved, do not and will not have an material adverse effect on the institution's financial condition, or the institution has insurance that will cover the liabilities arising from those events or conditions. Consequently, under the proposed regulations, the institution could not claim that the event or condition does not support the demand for financial protection or that the amount demanded is unreasonable based on the institution's assessment of the risk posed by the event or condition.

The proposed changes to § 668.91(a)(3)(v) would also clarify the regulation and conform it with existing regulations describing the alternative methods by which an institution may meet the financial responsibility standards. Section 668.91(a)(3)(v) would be revised to state the grounds on which a hearing official could find that a termination or limitation action based on an institution's failure of financial responsibility, an institution's failure of a past performance condition under § 668.174(a) or a failure of a past performance condition for persons affiliated with an institution under § 668.174(b)(1) was not warranted. The changes would not add substantive new restrictions, but simply conform § 668.91 to the substantive requirements already in current regulations. Thus, as revised, § 668.91(a)(3)(v) would require the hearing official to find that the limitation or termination for adverse past performance by the institution itself was warranted, unless the institution met the provisional certification and financial protection alternatives in current § 668.175(f). For an action based on the adverse past performance of a person affiliated with an institution, the hearing official would be required to find that limitation or termination of the institution was warranted unless the institution demonstrated either proof of repayment or that the person asserted to have substantial control in fact lacks or lacked that control, as already provided in § 668.174(b)(2), or that the institution has accepted provisional certification and provided the financial protection required under § 668.175.

This proposal is very similar to changes made to this section (previously designated as § 668.90) in the 2016 final regulations. 81 FR 76072. It parallels the changes made in those regulations to conform this section to existing regulations, but departs from them to conform to changes we are proposing in this notification. Specifically, because we propose here different actions or events that might cause an institution not to be financially responsible than were included in the 2016 final regulations, the changes we now propose to this section to this section track our current proposal. Therefore, we propose to rescind this provision of the 2016 final regulations.

Limitation (§ 668.94)

Statute: Section 487(c)(1)(F) of the HEA, 20 U.S.C. 1094, provides that the Secretary shall prescribe such regulations as may be necessary to provide for the limitation, suspension, or termination of an eligible institution's participation in any program under title IV of the HEA.

Current Regulations: Section 668.86 provides that the Secretary may limit an institution's participation in a title IV, HEA program, under specific circumstances, and describes procedures for the institution to appeal the limitation. Current § 668.94 lists types of specific restrictions that may be imposed by a limitation action, and includes in paragraph (i) ''other conditions as may be determined by the Secretary to be reasonable and appropriate.'' 34 CFR 668.94(i).

The regulations at § 668.13(c) provide that the Secretary may provisionally certify an institution whose participation has been limited or suspended under subpart G of part 668, and § 668.171(e) provides that the Secretary may take action under subpart G to limit or terminate the participation

of an institution if the Secretary determines that the institution is not financially responsible under § 668.171 or § 668.175.

Proposed Regulations: The Secretary proposes to amend § 668.94 to clarify that a change in an institution's participation status from fully certified to provisionally certified to participate in a title IV, HEA program under § 668.13(c) is a type of limitation that may be the subject of a limitation proceeding under § 668.86.

Reasons: The proposed change to § 668.94 would clarify current policy and provide for a more complete set of limitations covered in § 668.94. The 2016 final regulations included this same change to this regulation (previously designated as § 668.93, see 81 FR 76072), and we propose it again here to seek comment on it in the context of our complete current proposal.

Guaranty Agency (GA) Collection Fees (34 CFR 682.202(b), 682.405(b), and 682.410(b)(2) and (4))

Statute: Section 428F(a) of the HEA provides that to complete a FFEL borrower's loan rehabilitation, the FFEL guaranty agency must sell the loan to a FFEL Program lender or assign the loan to the Secretary.

Section 428H(e)(2) of the HEA allows a FFEL Program lender to capitalize outstanding interest when the loan enters repayment, upon default, and upon the expiration of periods of deferment and forbearance, but does not specifically authorize the capitalization of interest when the borrower rehabilitates a defaulted loan.

Current Regulations: The current FFEL Program regulations in §§ 682.202, 682.405, and 682.410 permit FFEL Program lenders to capitalize interest when the borrower enters or resumes repayment and requires a guaranty agency to capitalize interest when it pays the FFEL Program lender's default claim. However, these regulations do not specifically address whether a guaranty agency may capitalize interest when the borrower has rehabilitated a defaulted FFEL Loan or whether a FFEL Program lender may capitalize interest when purchasing a rehabilitated FFEL Loan from a guaranty agency. In addition, the Department interprets these regulations to bar guaranty agencies from imposing collection costs when a borrower enters into a satisfactory repayment agreement within 60 days of the first notice of default sent to the borrower.

Proposed Regulations: The proposed revisions to §§ 682.202, 682.405, and 682.410 would provide that the only time a guaranty agency may capitalize interest owed by the borrower is when it pays the FFEL Program lender's default claim. Therefore, the guaranty agency would not be allowed to capitalize interest when it sells a rehabilitated FFEL Loan.

Similarly, the proposed regulations would bar a FFEL Program lender from capitalizing outstanding interest when purchasing a rehabilitated FFEL Loan.

The proposed regulations would also provide that when a guaranty agency holds a defaulted FFEL Loan and the guaranty agency has suspended collection activity to give the borrower time to submit a closed school or false certification discharge application, interest capitalization is not permitted if collection on the loan resumes because the borrower does not return the appropriate form within the allotted timeframe.

Finally, the Department proposes to prohibit guaranty agencies from charging collection costs to borrowers who, within 60 days of receiving notice of default, enter into an acceptable repayment arrangement, including a loan rehabilitation plan.

Reasons: Recently, the Department became aware that some guaranty agencies and FFEL Program lenders were capitalizing interest when a borrower rehabilitates a loan, while others were not. In addition, some guaranty agencies were capitalizing interest when resuming collection on a defaulted FFEL Loan when a borrower had not submitted a closed school or false certification discharge within a specific timeframe. The Department does not believe that interest capitalization in either circumstance is appropriate, and the Department does not capitalize interest on loans that it holds in comparable circumstances.

Additionally, to encourage borrowers to enter into satisfactory repayment plans, the Department proposes that guaranty agencies may not assess collection costs to a borrower who enters into an acceptable repayment agreement, including a rehabilitation agreement, and honors that agreement, within 60 days of receiving notice of default.

The negotiators did not object to any of these changes. In addition, the 2016 final regulations included the changes we propose in this NPRM regarding interest capitalization when a borrower rehabilitates a loan, as well as when a guaranty agency resumes collection on a defaulted FFEL Loan when a borrower had not submitted a closed school or false certification discharge within a specific timeframe. 81 FR 76079–80. We propose these changes again here to seek comment on them in the context of our complete current proposal.

The changes we propose regarding collection costs for borrowers who enter into an acceptable repayment arrangement, including a loan rehabilitation plan, within 60 days of receiving notice of default were not included in the 2016 final regulations. These changes are consistent with the interpretation and position that the Department previously took in Dear Colleague Letter (DCL) GE–15–14 (July 10, 2015). That DCL was withdrawn in order to allow for public comment on our interpretation, which we seek through this notification.

Subsidized Usage Period and Interest Accrual (34 CFR 685.200(f))

Statute: Section 455(q) of the HEA provides that a first-time borrower on or after July 1, 2013, is not eligible for additional Direct Subsidized Loans if the borrower has received Direct Subsidized Loans for a period that is equal to or greater than 150 percent of the length of the borrower's current program of study (''150 percent limit''). In addition, some borrowers who are not eligible for Direct Subsidized Loans because of the 150 percent limit become responsible for the interest that accrues on their loans when it would otherwise be paid by the government. The statute does not address what effect a discharge of a Direct Subsidized Loan has on the 150 percent limit. The statute also does not address whose responsibility it is to pay the outstanding interest on any remaining loans that have not been discharged, but which have previously lost eligibility for interest subsidy.

Current Regulations: Section 685.200(f)(4) provides two exceptions to the calculation of the period of time that counts against a borrower's 150 percent limit—the subsidized usage period—that can apply based on the borrower's enrollment status or loan amount. The regulations do not have an exception to the calculation of a subsidized usage period if the borrower receives a discharge of his or her Direct Subsidized Loan. They also do not address whose responsibility it is to pay the outstanding interest on any remaining loans that have not been discharged, but have previously lost eligibility for the interest subsidy based on the borrower's remaining eligibility period and enrollment.

Proposed Regulations: Proposed § 685.200(f)(4)(iii) would specify that a discharge based on a school closure, false certification, unpaid refund, or borrower defense will lead to the elimination, or recalculation, of the subsidized usage period that is

associated with the loan or loans discharged.

The proposed regulations would also specify that, when the full amount of a Direct Subsidized Loan or a portion of a Direct Subsidized Loan is discharged, the entire subsidized usage period associated with that loan is eliminated. In the event that a borrower receives a closed school, false certification, or, depending on the circumstances, borrower defense or unpaid refund discharge, the Department would completely discharge a Direct Subsidized Loan or a portion of a Direct Subsidized Consolidation Loan that is attributable to a Direct Subsidized Loan.

The proposed regulations would also specify that, when only a portion of a Direct Subsidized Loan or a portion of a Direct Consolidation Loan that is attributable to a Direct Subsidized Loan is discharged, the subsidized usage period would be recalculated instead of eliminated. Depending on the circumstances, discharges due to a borrower defense or unpaid refund could result in only part of a Direct Subsidized Loan or only a portion of the part of a Direct Consolidation Loan that is attributable to a Direct Subsidized Loan being discharged.

The proposed regulations would specify that when a subsidized usage period is recalculated, the period is only recalculated if the borrower's subsidized usage period was calculated as one year as a result of receiving the Direct Subsidized Loan in the amount of the annual loan limit for a period of less than an academic year. For example, if a borrower received a Direct Subsidized Loan in the amount of $3,500 as a first-year student on a full-time basis for a single semester of a two-semester academic year, the subsidized usage period would be one year. If the borrower later receives an unpaid refund discharge in the amount of $1,000, the subsidized usage period would be recalculated, and the subsidized usage period would become 0.5 years because the subsidized usage period was previously based on the amount of the loan and, after the discharge, is based on the relationship between the period for which the borrower received the loan (the loan period) and the academic year for which the borrower received the loan.

In contrast, if the borrower received a Direct Subsidized Loan in the amount of $3,500 as a first-year student on a full-time basis for a full two-semester academic year, the subsidized usage period would be one year. If the borrower later receives an unpaid refund discharge in the amount of $1,000, the subsidized usage period would still be one year because the subsidized usage period would still be calculated based on the relationship between the loan period and the academic year for which the borrower received the loan.

Proposed § 685.200(f)(3) would provide that, if a borrower receives a discharge based on a school closure, false certification, unpaid refund, or a borrower defense discharge that results in a remaining eligibility period greater than zero, the borrower is no longer responsible for the interest that accrues on a Direct Subsidized Loan or on the portion of a Direct Consolidation Loan that repaid a Direct Subsidized Loan, unless the borrower once again becomes responsible for the interest that accrues on a previously received Direct Subsidized Loan or on the portion of a Direct Consolidation Loan that repaid a Direct Subsidized Loan, for the life of the loan.

For example, suppose a borrower receives Direct Subsidized Loans for three years at school A and then transfers to school B and receives Direct Subsidized Loans for three additional years. Further suppose that at this point, the borrower has no remaining Subsidized Loan eligibility period and enrolls in an additional year of academic study at school B, which triggers the loss of interest subsidy on all Direct Subsidized Loans received at schools A and B. If the borrower later receives a false certification discharge with respect to school B, the borrower's remaining eligibility period is now greater than zero. The borrower is no longer responsible for paying the interest subsidy lost on the three loans from school A. If the borrower then enrolled in school C and received three additional years of Direct Subsidized Loans, resulting in a remaining eligibility period of zero, and then enrolled in an additional year of academic study, the borrower would lose the interest subsidy on the Direct Subsidized Loans received at schools A and C.

Reasons: The proposed regulations would clarify and codify the Department's current practice in this area. Under the circumstances in which a borrower receives a closed school, false certification, borrower defense, or unpaid refund discharge, the borrower has not received all or part of the benefit of the loan due to an act or omission of the school. In such an event, we believe that a student's eligibility for future loans and the interest subsidy on existing loans should not be negatively affected by having received the loan. Accordingly, under the proposed regulations, we would increase the borrower's eligibility for Direct Subsidized Loans or reinstate the interest subsidy on other Direct Subsidized Loans under the 150 percent limit where the borrower receives a discharge of a Direct Subsidized Loan and the discharge was based on an act or an omission of the school that caused the borrower to not receive all or part of the benefit of the loan. The negotiators did not raise any objections to this change. The 2016 final regulations included these same changes to this regulation (81 FR 76080), and we propose them again here to seek comment on them in the context of our complete current proposal.

Appendix A to Subpart L, Part 668: Ratio Methodology for Proprietary Institutions

Section 1: Ratio and Ratio Terms

Primary Reserve Ratio $\frac{\textit{Adjusted Equity}}{\text{Total Expenses and Losses}}$

Equity Ratio $\frac{\textit{Modified Equity}}{\text{Modified Assets}}$

Net Income Ratio $\frac{\textit{Income before Taxes}}{\text{Total Revenues and Gains}}$

Definitions

Adjusted Equity = (total owner's equity) − (intangible assets) − (unsecured related-party receivables) * − (net property, plant and equipment) ** + (post-employment and defined benefit pension liabilities) + (all debt obtained for long-term purposes, not to exceed total net property, plant and equipment) ***

Total Expenses and Losses excludes income tax, discontinued operations not classified as an operating expense or change in accounting principle and any losses on investments, post-employment and defined benefit pension plans and annuities. Any losses on investments would be the net loss for the investments. Total Expenses and Losses include the nonservice component of net periodic pension and other post-employment plan expenses.

Modified Equity = (total owner's equity) − (intangible assets) − (unsecured related-party receivables)

Modified Assets = (total assets) − (intangible assets) − (unsecured related-party receivables)

Income before Taxes includes all revenues, gains, expenses and losses incurred by the school during the accounting period. Income before taxes does not include income taxes, discontinued operations not classified as an operating expense or changes in accounting principle.

Total Revenues and Gains does not include positive income tax amounts, discontinued operations not classified

as an operating gain, or change in accounting principle (investment gains should be recorded net of investment losses.

* Unsecured related party receivables as required at 34 CFR 668.23(d).

** The value of property, plant and equipment includes construction in progress and lease right-of-use assets, and is net of accumulated depreciation/amortization.

*** All debt obtained for long-term purposes, not to exceed total net property, plant and equipment includes lease liabilities for lease right-of-use assets and the short-term portion of the debt, up to the amount of net property, plant and equipment. If an institution wishes to include the debt, including debt obtained through long-term lines of credit in total debt obtained for long-term purposes, the institution must include a disclosure in the financial statements that the debt, including lines of credit exceeds twelve months and was used to fund capitalized assets (*i.e.,* property, plant and equipment or capitalized expenditures per Generally Accepted Accounting Principles (GAAP)). The disclosures that must be presented for any debt to be used in adjusted equity include the issue date, term, nature of capitalized amounts and amounts capitalized. Institutions that do not include debt in total debt obtained for long-term purposes, including long-term lines of credit, do not need to provide any additional disclosures other than those required by GAAP. The debt obtained for long-term purposes will be limited to only those amounts disclosed in the financial statements that were used to fund capitalized assets. Any debt amount including long-term lines of credit used to fund operations must be excluded from debt obtained for long-term purposes.

Section 2: Financial Responsibility Supplemental Schedule Requirement and Example

A Supplemental Schedule must be submitted as part of the required audited financial statements submission. The Supplemental Schedule contains all of the financial elements required to compute the composite score. Each item in the Supplemental Schedule must have a reference to the Balance Sheet, Statement of (Loss) Income, or Notes to the Financial Statements. The amount entered in the Supplemental Schedules should tie directly to a line item, be part of a line item, tie directly to a note, or be part of a note in the financial statements. When an amount is zero, the institution would identify the source of the amount as NA (Not Applicable) and enter zero as the amount in the Supplemental Schedule. The audit opinion letter must contain a paragraph that references the auditor's additional analysis of the financial responsibility Supplemental Schedule.

Executive Orders 12866, 13563, and 13771

Under Executive Order 12866, the Secretary must determine whether this regulatory action is ''significant'' and, therefore, subject to the requirements of the Executive Order and subject to review by the Office of Management and Budget (OMB). Section 3(f) of Executive Order 12866 defines a ''significant regulatory action'' as an action likely to result in a rule that may—

(1) Have an annual effect on the economy of $100 million or more, or adversely affect a sector of the economy, productivity, competition, jobs, the environment, public health or safety, or State, local, or tribal governments or communities in a material way (also referred to as an ''economically significant'' rule).

(2) Create serious inconsistency or otherwise interfere with an action taken or planned by another agency;

(3) Materially alter the budgetary impacts of entitlement grants, user fees, or loan programs or the rights and obligations of recipients thereof; or

(4) Raise novel legal or policy issues arising out of legal mandates, the President's priorities, or the principles stated in the Executive order.

Under Executive Order 12866,[9] section 3(f)(1), this regulatory action is economically significant and subject to review by OMB. Also under Executive Order 12866 and the Presidential Memorandum ''Plain Language in Government Writing'', the Secretary invites comment on how easy these regulations are to understand in the *Clarity of the Regulations* section.

Under Executive Order 13771,[10] for each new regulation that the Department proposes for notice and comment or otherwise promulgates that is a significant regulatory action under Executive Order 12866 and that imposes total costs greater than zero, it must identify two deregulatory actions. For FY 2018, no regulations exceeding the agency's total incremental cost allowance will be permitted, unless required by law or approved in writing by the Director of OMB. These proposed regulations are a deregulatory action under E.O. 13771 and therefore the two-for-one requirements of E.O. 13771 do not apply.

We have also reviewed these regulations under Executive Order 13563, which supplements and explicitly reaffirms the principles, structures, and definitions governing regulatory review established in Executive Order 12866. To the extent permitted by law, Executive Order 13563 requires that an agency—

(1) Propose or adopt regulations only on a reasoned determination that their benefits justify their costs recognizing that some benefits and costs are difficult to quantify);

(2) Tailor its regulations to impose the least burden on society, consistent with obtaining regulatory objectives and taking into account—among other things, and to the extent practicable—the costs of cumulative regulations;

(3) In choosing among alternative regulatory approaches, select those approaches that maximize net benefits (including potential economic, environmental, public health and safety, and other advantages; distributive impacts; and equity);

(4) To the extent feasible, specify performance objectives, rather than the behavior or manner of compliance a regulated entity must adopt; and

(5) Identify and assess available alternatives to direct regulation, including economic incentives—such as user fees or marketable permits—to encourage the desired behavior, or provide information that enables the public to make choices.

Executive Order 13563 also requires an agency ''to use the best available techniques to quantify anticipated present and future benefits and costs as accurately as possible.'' The Office of Information and Regulatory Affairs of OMB has emphasized that these techniques may include ''identifying changing future compliance costs that might result from technological innovation or anticipated behavioral changes.''

Under Executive Order 13563,[11] the Secretary certifies that the best available techniques were used to quantify the impacts of these regulations. Finally, the Secretary certifies that this regulatory action would not unduly interfere with State, local, and tribal governments in

[9] Exec. Order No. 12866, 58 FR 190 (October 4, 1993). *Regulatory Planning and Review.* Available at: *www.reginfo.gov/public/jsp/Utilities/EO_12866.pdf.*

[10] Exec. Order No. 13771, 82 FR 22 (January 30, 2017). *Reducing Regulation and Controlling Regulatory Costs.* Available at: *www.gpo.gov/fdsys/pkg/FR-2017-02-03/pdf/2017-02451.pdf.*

[11] Public Law 106–554 appendix C 114 STAT 2763A–153–155. section 515 Available at: *www.gpo.gov/fdsys/pkg/PLAW-106publ554/pdf/PLAW-106publ554.pdf.*

the exercise of their governmental functions.

The Department has analyzed the need for regulatory action, alternatives available to it, and measured the impact of the changes that would result from the proposed regulations relative to the existing regulatory baseline under a cost-benefit approach. The required Accounting Statement is included in the *Net Budget Impacts* section.

Regulatory Impact Analysis (RIA)

As further detailed in the *Net Budget Impacts* section, this proposed regulatory action would have an annual effect on the economy of approximately $697 million in transfers among borrowers, institutions, and the Federal Government related to defense to repayment and closed school discharges, as well as $1.15 million in costs to comply with paperwork requirements. This economic estimate was produced by comparing the proposed regulation to the PB2019 budget. As explained in Section (B)(1)(Baseline) of this RIA, we compare the proposed regulations to the delayed 2016 regulations. We discuss the need for regulatory action; regulatory alternatives considered; costs, benefits, and transfers; net budget impacts and accounting statement; regulatory flexibility act (small business impacts); and paperwork reduction.

A. Need for Regulatory Action

These proposed regulations address a significant increase in burden resulting from the vast increase in borrower defense claims since 2015. The 2016 borrower defense regulations fail to adequately address this increase in burden. These proposed regulations reduce burden by restoring the limitation of defense to repayment claims to those loans that are in certain collections proceedings, provide an opportunity for institutions to submit a response to borrower allegations, and provide for the Secretary to recover losses from institutions.

Although the borrower defense to repayment regulations have provided an option for borrower relief for borrowers in a collections proceeding since 1994, in 2015 the number of borrower defense to repayment claims increased dramatically when institutions owned by Corinthian Colleges, Inc., were placed on Heightened Cash Monitoring 1 (HCM1) status with an additional 20 day hold and the company declared bankruptcy. Students enrolled at Corinthian campuses and those who had left the institution within 120 days of its closure were eligible for a closed school loan discharge. The Department decided to also provide student loan discharge to additional borrowers who did not qualify for a closed school loan discharge, but could qualify under a new interpretation of the defense to repayment regulation (34 CFR 685.206(c)). The Department encouraged Corinthian borrowers to submit defense to repayment claims, which it agreed to consider for all Corinthian-related loans, including those not in a collections proceeding. We refer to these claims as affirmative claims, as opposed to defensive claims, which require the loan to be in a collections proceeding.

This resulted in a significant increase in claim volume compared to the prior years, when claim volume was no more than 10 in any given year. Since 2015, the Department has considered both affirmative and defensive claims, thus significantly expanding the number of claims received and the potential cost to the Federal budget. The 2016 regulations also provide that borrowers could submit both affirmative and defensive claims.

The proposed regulations revert back to the plain meaning of the regulation, as it had been implemented prior to 2015, such that only those borrowers in a collection proceeding would have a mechanism by which they could exercise defenses to repayment. With the anticipated substantial increase in the number of defense to repayment applications, the Department believes that revisions to the 2016 regulations are necessary.[12] However, the Department is also seeking comment on continuing to accept affirmative claims and, if such claims were accepted, on ways of reducing burden and taxpayer liability associated with affirmative claims, since borrowers have nothing to lose by attempting to seek student loan relief, even if misrepresentation or harm as a result of misrepresentation did not occur. In addition, provisions in the 2016 regulation that enable the Secretary to initiate defense to repayment claims on behalf of entire classes of borrowers in a collection proceeding to exercise defenses to repayment as a last resort after exhausting other available consumer protection processes. The Department also realized that claims received from borrowers who had attended institutions that the Department had not investigated or found instances of misrepresentation (*i.e.,* other than Corinthian)create the potential for unsubstantiated claims that place no burden on the part of the borrower, but significant burden on the part of the Department, it needed a mechanism to collect evidence from institutions and to provide an opportunity for those institutions to defend themselves against frivolous claims. Because an institution might withhold official transcripts from students who receive a defense to repayment loan discharge, (as institutions are permitted to do in the case of loan discharges), automatic discharges could have collateral consequences for students who unknowingly had their loans discharged. An ''opt out'' mechanism could result in borrowers who unknowingly lose the ability to verify the credentials they earned using the subsequently discharged loans. Therefore, the Department believes that it is imperative that individual borrowers apply for a closed school loan discharge rather than receiving it automatically.

The group discharge process, which would be removed by the proposed regulations, may otherwise create large and unnecessary liabilities for taxpayer funds. If group claims initiated by the Secretary include borrowers who were not subjected to the misrepresentation, did not rely on a misrepresentation to make an enrollment decision, or were not harmed by the misrepresentation then those borrowers' loans should not be forgiven with taxpayer funds. The Department believes that institutions should be held accountable for acts or omissions that constitute misrepresentation, but that arbitration, other student complaint resolution or legal proceedings brought in State court should serve as the primary means for borrowers to seek remedies against such acts.

The increased number of school closures in recent years has prompted the Department to review regulations related to closed schools and therefore 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 Department proposes to expand the closed school discharge window from 120 days to 180 days prior to the school's closure. These regulations also

[12] U.S. Department of Education Office of Inspector General (December 8, 2017), ''Federal Student Aid's Borrower Defense to Repayment Loan Discharge Process'', retrieved from *www2.ed.gov/about/offices/list/oig/auditreports/fy2018/i04r0003.pdf.*

incentivize institutions 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 teach-out opportunity must be approved by the accreditor and, if applicable, the State authorizing agency. In the proposed regulation, a borrower given the opportunity to complete his or her program through an orderly teach-out at a closing institution, or through a partnership with another institution, would not be eligible for closed school loan discharge. This mirrors the existing regulations that 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. The teach-out opportunity must be approved by the accreditor and, if applicable, the State authorizing agency to ensure that the institution or its teach-out partner institution continues to provide educational and student support services that meet the accreditor's and agency's standards. Although the 2016 regulations included an automatic closed school loan discharge for eligible borrowers who did not re-enroll within 3 years of their school's closure, upon further consideration, the Department has determined that this could have unintended consequences for students because an institution, 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 end up by default participating in an action that could prevent them from verifying their credits or credential in the future. The Department has heretofore favored opt-in requirements rather than opt-out requirements, such as in the case of Trial Enrollment Periods (*https://ifap.ed.gov/dpcletters/GEN1112.html*), to be sure that a student's omission does not result in actions with negative financial or academic consequences. The opt-out provision also could increase the cost to the taxpayer, including for borrowers who are not seeking relief, because default provisions typically capture a much larger population than opt-in provisions. Therefore, the proposed regulations require borrowers to submit an application in order to receive a closed school loan discharge.

The proposed regulations also update the Department's regulations regarding false certification loan discharges in response to the change made to the HEA by Public Law 112–74, Consolidated Appropriations Act, 2012, that eliminated the option for students who did not have a high school diploma or its equivalent to receive Title IV aid by demonstrating the 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. Now 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 borrower may receive title IV financial aid, but will not then be eligible for a false certification discharge if the borrower had misstated the truth in signing the attestation.

These proposed regulations also address several provisions related to determining the financial responsibility of institutions and requiring surety in the event that the school's financial health is threatened. The Financial Accounting Standards Board (FASB) recently issued updated accounting standards that change the way that lease liabilities are considered in determining an institution's financial position. To align with these new standards, these proposed regulations update the definition of terms used in 34 CFR part 668, subpart L, appendices A and B, which are used to calculate an institution's composite score. The composite score methodology must be updated to align with the new FASB standards, but in the meantime, the misalignment between the new FASB standards and the old composite score methodology could have unintended consequences. Some of these consequences could include institutions signing shorter term equipment or facilities leases, thereby increasing the cost of education, or potentially even closing schools whose financial position hasn't changed from prior years, thereby increasing the number of closed school loan discharges. Therefore, the Department would continue to calculate the composite score under the prior FASB standard (''alternative composite score'') for institutions that would have passed the composite score under that standard but not the current standard. This alternative composite score methodology will be in place for the six years following the implementation of the new FASB standard or until an updated composite score is developed through negotiated rulemaking, whichever is sooner.

In addition, the proposed regulations expand the financial responsibility requirements and add surety requirements in response to certain triggering events that occur between audit cycles. Instead of relying solely on information contained in an institution's audited financial statements, which are submitted to the Department six to nine months after the end of the institution's fiscal year, we propose to determine at the time that certain events occur whether those events have a material adverse effect on the institution's financial condition. In cases where the Department determines that an event poses a materially adverse risk, this approach would enable us to address that risk quickly by taking the steps necessary to protect the Federal interest.

We adopted a similar approach in the 2016 final regulations, but here we propose to focus on known and quantifiable expenses. For example, the actual liabilities incurred from defense to repayment discharges could trigger surety requirements, but the existence of pending litigation may or may not have a financial impact on the school. We are proposing additional surety requirements for other metrics or events for which the potential consequences pose a severe and imminent risk (for example, SEC or stock exchange actions) to the Federal interest.

We propose other triggering events, such as high cohort defaults rates, loan agreement violations, and accrediting agency actions, that could have a material adverse effect on an institution's operations or its ability to continue operating, but the Department intends to fully consider the circumstances surrounding such event before making a determination that the institution is not financially responsible. In that regard, these proposed regulations do not contain certain mandatory triggering events that were included in the 2016 regulations because the cost and burden of seeking surety is significant, and in many cases speculative events, such as pending litigation or pending defense to repayment claims, may be resolved with no or minimal financial impact on the institution. Similarly, while the 2016 regulations included a mandatory surety for all State law violations, the Department recognizes that many violations do not threaten the financial stability or existence of the institution and therefore should not trigger

mandatory surety requirements. These regulations also do not include as a mandatory triggering event the results of a financial stress test, which was included in the 2016 regulations without an explanation of what that stress test would be and on what empirical basis it would be developed.

B. Alternatives Considered

The Department and the non-Federal negotiators exchanged proposals on every topic included in these proposed regulations. The table below provides a side-by-side comparison of the 2016 regulations, the proposed regulations, and two alternatives—Scenario 1 and Scenario 2. OMB circular A–4 requires that agencies carefully consider all appropriate alternatives for the key attributes or provisions of a rule. They generally should analyze at least three options: The preferred option; a more stringent option that achieves additional benefits (and presumably costs more) beyond those realized by the preferred option; and a less stringent option that costs less (and presumably generates fewer benefits) than the preferred option. The 2016 regulations are summarized in this section and are also available to the reader online.[13] The specifics of the alternatives selected are discussed more thoroughly in this section. Scenario 1 reflects a more stringent option. Scenario 2 reflects the regulations currently in effect (which in the case of defense to repayment dates back to 1994). Further, the HEA refers to proprietary institutions, but some of the Department's prior notifications and regulations use the term ''private, for-profit institutions.'' For the purposes of discussion, the Department defines private, for-profit institutions to be the same as proprietary institutions, and uses the term ''proprietary institution'' throughout in order to be consistent with the HEA.

TABLE 1—COMPARISON OF ALTERNATIVES

Topic	Baseline	Proposal	Scenario 1	Scenario 2
Closed school discharge eligibility window.	120 days	180 days	150 days	120 days.
Closed school discharge exclusions.	Borrower completed teach-out or transferred credits.	School offered a teach-out plan.	School offered a teach-out plan.	Borrower completed teach-out or transferred credits.
Borrower Defense claims accepted.	Affirmative and defensive	Defensive only	Affirmative and defensive	Defensive only.
Party that adjudicates borrower defense claims.	Department	Department	State court or arbiter	Department.
Standard for borrower defense claims.	Federal Standard	Federal standard	State laws	State laws.
Borrower defense application process.	Application	Select borrower defense in response to wage garnishment or similar actions.	Submit judgment from state court or similar using application.	Submit sworn attestation or application.
Loans associated with BD claims.	Forbearance during adjudication Interest accrues.	Forbearance not necessary	Forbearance not necessary	Forbearance during adjudication Interest accrues.
Composite score calculation and timeline.	No FASB updates	Higher of current or FASB-updated score forever.	Higher of current or FASB-updated score for 6 years, then FASB-updated score.	No FASB updates.
Financial responsibility triggers	Reporting that automatically results in surety request.	New reporting that may result in surety request.	New reporting that automatically results in surety request.	None.
Notification of mandatory arbitration and class action waivers.	Prohibits mandatory arbitration clauses and class action waivers.	On website and entrance counseling.	On website, during entrance and exit counseling, and annually by email to students.	None.

1. Baseline

Usually, the impact of a regulation is quantified relative to the regulations currently in effect, which in this case would be the borrower defense regulations from 1995, and associated data. However, this impact analysis does not follow that practice because the 2016 regulations, although not yet in effect, would go into effect were it not for these proposed regulations. Therefore, this analysis compares the proposed regulations to the 2016 borrower defense regulations rather than the 1995 regulations. Similarly, the delayed 2016 regulations on financial responsibility, closed school discharges, and false certification discharges are used as a baseline for these topics. Composite score calculations and FASB standards were not covered in the 2016 regulations, so they are compared to the regulations currently in effect.

2. Summary of Proposed Regulations

The proposed regulations would amend the baseline regulations to update composite score calculations to comply with new FASB standards, create an alternative composite score that does not include new FASB standards for lease liabilities, require institutions to disclose fewer adverse events to the Department and notify students of mandatory arbitration or class-action prohibitions, permit mandatory arbitration clauses and class-action waivers, expand the closed school discharge eligibility period, modify the conditions under which a Direct Loan borrower may qualify for false certification and closed school discharges, create a different process for adjudicating defense to repayment applications, and, as part of the adjudication process, provide that the Secretary will used the revised misrepresentation standard explained in this NPRM, request evidence from institutions prior to completing adjudication of any borrower defense claims. Finally, the Department is also proposing changes to the regulations regarding subsidy usage periods and collection costs charged by guaranty agencies.

3. Alternative Scenario 1

Under Scenario 1, the Department would require borrowers to submit a judgment from a Federal or State court or arbitration panel to qualify for a defense to repayment discharge. Scenario 1 would not include a process for the Department to adjudicate claims because claimants would already have obtained a decision from a court or arbitrator at the State level. This alternative would place an increased burden on borrowers if they decide to

[13] *https://www.gpo.gov/fdsys/pkg/FR-2016-11-01/pdf/2016-25448.pdf.*

hire a lawyer in order to present their claims to a State court or incur costs associated with an arbitration proceeding. Moreover, because consumer protection laws vary by State, a borrower filing a claim in one State may be subject to different criteria compared to a borrower filing a defense to repayment claim in another State. It may also be unclear as to which State serves as the relevant jurisdiction for a given borrower.

Under Scenario 1, a guaranty agency would be able to charge a borrower collection fees and capitalize interest after rehabilitating a loan. The closed school discharge eligibility window would be expanded to 150 days, but only students whose institutions did not offer them a teach-out plan would be eligible for such a discharge.

This scenario would require an institution to notify current and potential students of its pre-dispute arbitration and class-action waiver policies on its website, at entrance and exit counselling for all title IV borrowers, and annually to all enrolled students by email. Institutions would also be required to disclose certain financial responsibility risk events to the Department if they occur.

Lastly, this scenario would implement revisions to FASB standards in the calculation of an institution's composite score without a transition period and would prevent an institution from appealing the composite score calculation. This scenario would include a requirement that the institution automatically provide a surety in the event that a financial responsibility risk event occurs.

4. Alternative Scenario 2

Scenario 2 would be to rescind the 2016 regulations on borrower defenses and go back to the 1995 regulations. In Scenario 2 the Department would accept only defensive borrower defense claims to repayment applications or attestations and adjudicate them, applying a State law standard. Under this alternative, borrowers could elect to have loans placed in forbearance while their claims are adjudicated.

Scenario 2 would return the eligibility period for closed school discharge to 120 days. Borrowers who complete a teach-out or transfer credits would not qualify. The technical changes to the false certification discharge provisions reflected in the 2016 regulations would be rescinded.

C. In Scenario 2, no Changes to the Composite Score or Financial Responsibility Standards Would Be Made as a Result of Changes to the FASB Standards

Under this scenario, a guaranty agency could not capitalize interest or charge collection fees on a loan that is sold following the completion of loan rehabilitation, which is current Department practice in the Direct Loan Program.[14]

Costs, Benefits, and Transfers

These proposed regulations will affect all parties participating in the title IV, HEA programs. In the following sections, the Department discusses the effects these proposed regulations may have on borrowers, institutions, guaranty agencies, and the Federal government.

1. Borrowers

These proposed regulations would affect borrowers relative to defense to repayment applications, closed school discharges, false certification discharges, loan rehabilitation, and institutional disclosures. Borrowers may benefit from an ability to appeal to the Secretary if a guaranty agency denies their closed school discharge application, from the cost savings and campus stability associated with longer leases from a more generous ''look back'' period with regard to closed school loan discharges, and from the ability to increased opportunities for borrowers to complete their program through an approved teach-out plan. Borrowers are also more likely to have their defense to repayment applications processed and decided more quickly if the Department has a smaller volume of unjustified or ineligible claims.

Borrowers may be disadvantaged by receiving fewer opportunities to discharge loans if the Department returns to the pre-2015 practice of accepting defense to repayment claims only from borrowers in a collections proceeding. In addition, the Department is concerned that students could engage in strategic defaults in order to avail themselves to defense to repayment relief. Students who default and then are unsuccessful in receiving defense to repayment loan relief may suffer additional financial penalties and have the default listed on their credit report. Therefore, the Department is considering continuing to accept affirmative claims to enable borrowers who are harmed by misrepresentations to seek relief while they are in repayment. In the event that the Department continues to accept affirmative claims, it will place certain limits and conditions on the affirmative claims process to serve borrowers who were harmed while preventing frivolous claims. These limits will also ensure that the affirmative claim process aligns with the Department's record retention policies so that institutions will have the ability to respond to the borrower's claim. Some borrowers may incur burden to review institutional disclosures on mandatory arbitration and class action waivers, or to complete applications for defense to repayment discharges, and there could be additional burden to borrowers who would otherwise, through no affirmative action on their part, be included in a class-action proceeding.

a. Borrower Defenses

When defense to repayment discharge applications are successful, dollars are transferred from the Federal government to borrowers because borrowers are relieved of an obligation to pay the government for the loans being discharged. As further detailed in the *Net Budget Impacts* section, the Department estimates that annualized transfers from the Federal Government to affected borrowers, partially reimbursed by institutions, would be reduced by $693.9 million. This is based on the difference in cashflows associated with loan discharges when the proposed regulations are compared to the President's Budget 2019 baseline (PB2019) and discounted at 7 percent. The proposed regulations do not include a formula for computing partial discharges because partial discharges are based on the nature of each borrower's application and the magnitude of the harm experienced by the borrower. The Department is interested in options for determining partial relief and invites commenters to submit specific formulae for determining partial relief derived from an assessment of the financial harm the borrower experienced, as well as sources of data that could be used to support the recommended formulae. To the extent borrowers with successful defense to repayment claims have subsidized loans, the elimination or recalculation of the borrowers' subsidized usage periods could relieve them of their responsibility for accrued interest and make them eligible for additional subsidized loans. A borrower defense discharge is a remedy available to students when other consumer protection tools are ineffective. Students harmed by institutional misrepresentations continue to have the right to seek relief directly from the

[14] *https://ifap.ed.gov/dpcletters/GEN1514.html.*

institution through arbitration, lawsuits in State court, or other available means. Borrowers would possibly receive quicker and more generous financial remedies from institutions through arbitration since schools may be more motivated to make students whole in order to avoid defense to repayment claims. The 2016 regulations would have eliminated this complaint resolution option by prohibiting mandatory arbitration, and while institutions may have continued to provide voluntary arbitration, schools may not have made it obvious to students how to avail themselves of arbitration opportunities. The proposed regulation allows for mandatory arbitration clauses, but requires institutions to provide the borrower with information about the meaning of a mandatory arbitration clauses and how to use the arbitration process in the event of a complaint against the institution. The benefit of arbitration is that it is more accessible and less costly to students and institutions than litigation. For borrowers who seek relief from a court, there may be additional advantages since courts can award damages beyond the loan value, which the Department cannot do. The proposed regulations, therefore, would provide borrowers with the incentive to seek redress first from institutions that should incur the cost of the harm to the student. Only as a last resort should taxpayer funds be used to pay the costs of institutional misrepresentations.

b. Closed School Discharges

Some borrowers may be impacted by the proposed changes to the closed school discharge regulations. These proposed regulations would extend the window for a student's eligibility for a closed school discharge from 120 to 180 days from the date the school closed, to account for the days a student would be unable to attend an institution during a summer term at institutions that offer no or only limited classes during that time. The regulations would provide that borrowers offered a reasonable teach-out plan by their institutions would not be eligible for closed school discharges, if the plan was approved by the institution's accrediting agency and, if applicable, the institution's State authorizing agency. These proposed regulations also eliminate the regulations that provided for an automatic closed school discharge without application for students that had not received a closed school discharge or re-enrolled at a title IV participating institution within 3 years of a school's closure. While the automatic discharge may benefit some students who no longer would need to submit an application to receive relief, it may have disadvantaged students who wish to continue their education at a later time or provide proof of credit completion to future employers. There could also be tax implications associated with closed school loan discharges, and borrowers should be aware of those implications and given the opportunity to make a decision according to their needs and priorities.

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. The reduced availability of closed school discharges because of the teach-out provision and the elimination of the 3-year automatic discharge may reduce debt relief for students who believe that their education provided no benefits, but have not tried to transfer credits or complete their program elsewhere. As further detailed in the *Net Budget Impacts* section, the Department estimates that annualized closed school discharge transfers from the Federal Government to affected borrowers would be reduced by $96.5 million, primarily due to the elimination of automatic closed school discharges. This is based on the difference in cashflows associated with loan discharges when the proposed regulations are compared to the President's Budget 2019 baseline (PB2019) and discounted at 7 percent. The Department's accreditation standards [15] require accreditors to approve teach-out plans at institutions under certain circumstances, which emphasizes the importance of these plans to ensuring that students have a chance to complete their program should the school decide, or be required, to close. Teach-out plans that would require extended commuting time for students or that do not cover the same academic programs as the closing institution likely would not be approved by accreditors, and therefore would not negate a student's access to closed school discharges. In addition, an institution whose financial position is so degraded that it could not provide adequate instructional or support services would similarly not have their teach-out plan approved, thus enabling borrowers at those institutions to obtain a closed school discharge. In the case of two large, precipitous closures in 2015 and 2016, it is possible that enabling those institutions to teach-out their current students—including by arranging teach-outs plans delivered by other institutions or under the oversight of a qualified third party—would have benefited students and saved hundreds of millions of dollars of taxpayer funds.

Large numbers of small, private non-profit colleges could close in the next 10 years, which could contribute significantly to the cost of closed school discharges if these institutions are not encouraged to provide high quality teach-out options to their students.[16] By way of example, Mt. Ida College announced [17] that it would close at the end of the Spring 2018 semester and while the institution had considered entering into a teach-out arrangement with another institution, this did not materialize. While there may be other institutions that will accept credits earned at Mt. Ida, due to the distance between Mt. Ida and other campuses, it may be impractical for the student to attend another institution.[18] A proper teach-out plan may have enabled more students to complete their program. The requirement of accreditors to approve such options ensures protection for borrowers to ensure that a teach-out plan provides an accessible and high quality opportunity to complete the program.

c. False Certification Discharges

Some borrowers may be impacted by the proposed changes to the false certification discharge regulations, although this provision of the proposed regulations simply updates the regulations to codify current practice required as a result of the removal of the ability to benefit option as a pathway to eligibility for title IV aid. In the past, a student unable to obtain a high school diploma could still receive title IV funds if he or she could demonstrate that he or she could benefit from a college education.

With that pathway eliminated by a statutory change, prospective students unable to obtain high school transcripts when applying for admission to a postsecondary institution would be allowed to certify to their institutions that they graduated from high school or completed a home school program and qualify for Federal financial aid. At the same time, it will disallow students who misrepresented the truth in signing such an attestation from subsequently seeking

[15] 34 CFR 602.24(c).

[16] *www.insidehighered.com/news/2017/11/13/spate-recent-college-closures-has-some-seeking-long-predicted-consolidation-taking.*

[17] *www.insidehighered.com/news/2018/04/09/mount-ida-after-trying-merger-will-shut-down.*

[18] *www.insidehighered.com/news/2018/04/23/when-college-goes-under-everyone-suffers-mount-idas-faculty-feels-particular-sense.*

false certification discharge. Although the Department has not seen an increase in false certification discharges as a result of the elimination of the ability to benefit option, given the increased awareness of various loan discharge programs, the Department believes it is prudent to set forth in regulation that in the event a student falsely attests to having received a high school diploma, the student would not be eligible for a false certification discharge. Codifying this practice will not have a significant impact, but will ensure that students unable to obtain an official diploma or transcript will retain the opportunity to participate in postsecondary education. The Department does not believe that there are significant numbers of students who are unable to obtain an official transcript or diploma, but recent experiences related to working with institutions following natural disasters demonstrates that this alternative for those unable to obtain an official transcript is important.

d. Institutional Disclosures of Mandatory Arbitration Requirements and Class Action Waivers

Borrowers, students, and their families would benefit from increased transparency from institutions' disclosures of mandatory arbitration clauses and class action lawsuit waivers in their enrollment agreements. Under the proposed regulations, institutions would be required to disclose that their enrollment agreements contain class action waivers and mandatory arbitration clauses. Institutions would be required to make these disclosures to students, prospective students, borrowers, and their families on institutions' websites and in their marketing materials. Further, borrowers would be notified of these during entrance counselling. As further discussed in the *Paperwork Reduction Act section,* we estimate there is 5 minutes of burden to 342,407 borrowers annually at $16.30 [19] per hour to review these notifications during entrance counseling, for an annual burden of $446,506.

As institutions began preparing to implement the 2016 regulations, some eliminated both mandatory and voluntary arbitration provisions to be sure they would be in compliance with the letter and spirit of the regulations. Under the proposed regulations, institutions would be able to include these provisions in their enrollment agreements. The effect will be to require borrowers to redress their grievances through a quicker and less costly process, which we believe will benefit both the institution and the borrower by introducing the judgment of an impartial third party, but at a lower cost and burden than litigation. Arbitration may be in the best interest of the student because it could negate the need to hire legal counsel and result in adjudication of a claim more quickly than in a lawsuit or the Department's 2016 borrower defense claim adjudication process. Mandatory arbitration also reduces the cost impact of unjustified lawsuits to institutions and to future students, because litigation costs are ultimately passed on to future students through tuition and fees. It also increases the likelihood that damages will be paid directly to students, rather than used to pay legal fees.

2. Institutions

Institutions will be impacted by the proposed regulations in the areas of borrower defenses, closed school discharges, false certification discharges, FASB accounting standards, financial responsibility standards, and information disclosure. The benefits to institutions include a decrease in the number of reimbursement requests resulting from Department-decided loan discharges based on borrower defenses, closed school, and false certification; an increased involvement in the borrower defense adjudication process; the ability to continue to receive the benefit from the cost savings associated with longer-term leases and reduced relocation costs until such time as the composite score methodology can be updated through future negotiated rulemaking; and the ability to incorporate arbitration and class action waivers in enrollment agreements. Institutions may incur costs from increased arbitration and internal dispute resolution and increased expenses to provide for teach-out plans in the event of a school closure.

1. Borrower Defenses

Most institutions would not be burdened by the proposed regulatory changes in borrower defense to repayment. We estimate that successful defense to repayment applications under the proposed Federal standard and process for defensive claims will affect only a small proportion of institutions. The Department expects that the changes in these regulations would result in fewer successful defense to repayment applications, and therefore fewer discharges of loans. Therefore, the Department expects to request fewer repayment transfers from institutions to cover discharges of borrowers' loans. Under the main budget estimate explained further in the *Net Budget Impacts* section, the Department estimates an annual reduction of reimbursements of borrower defense claims from institutions to the government of $223 million under the seven percent discount rate. However, the Department believes that by requiring institutions that utilize mandatory arbitration clauses to provide plain language information to students about the role of mandatory arbitration clauses and the process to access arbitration, more students may take advantage of arbitration to settle disputes. In addition, given the benefits to both students and institutions of resolving complaints through arbitration, more institutions could offer arbitration opportunities, which could result in added costs to institutions for arbitration and added financial benefits to students who may more easily seek and be awarded financial remedies.

2. Closed School Discharges

A small percentage of institutions close annually, with some institutions providing teach-out opportunities to enable students to complete their programs and others leaving students to navigate the closure on their own, resulting in their eligibility for closed school loan discharges. Although the proposed regulations expand the eligibility window for students who left the institution but are still eligible to receive closed school loan discharges from 120 to 180 days it codifies current practice under which borrowers who were provided an approved teach-out plan by their institution will have completed their credential, and therefore would not qualify for closed school loan discharges. The Department has worked with a number of schools that have successfully completed teach-out plans, to the benefit of borrowers and taxpayers. As additional schools close in the future, the Department wants to encourage them to engage in orderly teach-outs rather than precipitous closures. We believe the proposed regulations would encourage institutions to provide teach-out opportunities, despite their high cost, if they reduce the total liability that would result from having to reimburse the Secretary for losses due to closed school discharges. While teach-outs are costly to institutions, they better serve students and reduce the risk to taxpayers, and therefore should be incentivized.

Title IV-granting institutions are required by their accreditors [20] to have

[19] Students' hourly rate estimated using BLS for Sales and Related Workers, All Other, available at: *www.bls.gov/oes/2017/may/oes_nat.htm#41-9099.*

[20] 34 CFR 602.24(c).

an approved teach-out plan on file and to update that plan with more specific information in the event that the institution is financially distressed, is in danger of losing accreditation or State authorization, or is considering a voluntary teach-out for other reasons. Because accreditors, and in some cases, State authorizing agencies, must approve teach-out plans and carefully monitor teach-out activities, only those students who can be provided a high quality education will not be eligible for a closed school loan discharge under this provision.

The Department is not including in these regulations provisions for automatic closed school discharges for students who do not complete their program 3 years after the school closed, which it included in the 2016 regulations. It is inappropriate for the Secretary to grant such loan discharges without receiving an application from the borrower.

These proposed regulations will encourage more institutions to engage in teach-out plans rather than precipitous closures, which would generate significant savings to taxpayers. Although teach-outs have considerable cost for institutions, these costs will be offset by reducing the number of borrowers who seek and are granted closed school discharges. It is important to keep in mind that closed schools include branch campuses and additional locations of main campuses that continue to operate. The Department has recognized the benefits of helping students complete their programs prior to school closures, and therefore sees benefit in promoting orderly teach-outs.

3. False Certification Discharges

A small percentage of institutions are affected by false certification discharges annually. However, elimination of the ability to benefit option for Title IV eligibility could result in growth in the coming years of the number of students who enroll having attested to receiving a high school diploma since an official high school diploma or transcript is not available. To ensure that the unintended consequence of this policy change is not an increase in the frequency or cost of false certification discharges, the Department believes it is necessary to specify that a student who misrepresents his or her high school completion status under penalty of perjury cannot then pursue a false certification loan discharge due to non-completion of high school, a GED or a home school program.

The proposed regulations would continue to permit institutions to obtain written assurance from prospective students who are unable to obtain their high school transcripts when applying for admission and Federal financial aid, without exposing themselves to financial liabilities should those students misrepresent the truth in their attestations. Although we believe this proposed regulation will not have a significant impact in the short term, primarily because the Department receives very few false certification discharge requests, the elimination of the ability to benefit option could result in increased numbers of enrollments by attestation, which could in turn increase the frequency and cost of false certification discharges in the future. The proposed regulations also will protect institutions as they seek to serve students who are pursuing postsecondary education but cannot obtain an official diploma or transcript.

This provision may result in small cost savings to some affected institutions, but mostly it ensures that adult students who are most likely to have difficulty in obtaining official transcripts maintain the ability to pursue higher education without increasing the risk of financial losses to taxpayers.

4. Financial Responsibility Standards

Both the 2016 final regulations and the proposed regulations include conditions under which institutions would have to provide a letter of credit or other form of surety in order to continue to participate in the title IV, HEA programs. The following table compares the financial responsibility triggers established by the 2016 final regulations and in the proposed regulations. Mandatory events or actions automatically result in a determination that the institution is not financially responsible and trigger a request for surety from the institution, whereas discretionary events or actions give the Secretary the discretion to make that determination at the time the event or action may occur.

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Table 2: Financial Responsibility Triggers

Financial Responsibility Trigger		2016 Regulation	Proposed Regulation	Change Summary
Mandatory Actions or Events: Recalculated composite score < 1.0	Action or Event triggers Secretary decision and surety to Department	Actual or projected expenses incurred from a triggering event	Actual expense incurred from a triggering event	Eliminates projected expenses
	Defense to repayment that does or could lead to an institution repaying government for discharges	Department has received or adjudicated claims associated with the institution	Department has discharged loans resulting from adjudicated claims	• Changed from Discretionary to Mandatory • Reduced to actual discharges only
	Lawsuits and Other Actions that does or could lead to institution paying a debt or incurring a liability	• Final judgment in a judicial proceeding, administrative proceeding or determination, or final settlement • Legal action brought by a Federal or State Authority pending for 120 days • Other lawsuits that have survived a motion for summary judgment or the time for such a motion has passed	• Final judgment in a judicial proceeding, administrative proceeding, or determination	Reduced to final judgments with public records
	Withdrawal of Owner's Equity at proprietary institutions	Excludes transfers between institutions with a common composite score	Excludes transfers to affiliated entities included in composite score or to an owner	Revised
ry Actions or	Non-Title IV Revenue (90/10): fails in most recent fiscal year	At proprietary institutions	At proprietary institutions	No Change

Financial Responsibility Trigger		2016 Regulation	Proposed Regulation	Change Summary
	Cohort Default Rates	Two most recent rates are 30 percent or above after any challenges or appeals	Two most recent rates are 30 percent or above after any challenges or appeals	No Change
	SEC or Exchange Actions regarding the institution's stock (Publicly Traded Institutions)	• Warned SEC may suspend trading • Failed to file required report with SEC on-time • Notified of noncompliance with Stock exchange requirements • Stock delisted	• Notified that SEC will suspend trading • Failed to file required report with SEC on-time and outside of a negotiated extension • Notified of noncompliance with Stock exchange requirements • Stock delisted	Changed notification requirements from warning by the SEC, which a publicly traded company is not required to communicate to shareholders, to a notification by the SEC, about which a company must notify shareholders.
	Accreditor Actions – Teach-Outs	Accreditor requires institution to submit a teach-out plan for closing the institution, a branch, or additional location	Removed	Reduced liability
	Gainful Employment	Programs one year away from losing their eligibility for title IV, HEA program funds due to GE metrics	Removed	Regulatory update
Discretionary Actions or Events	Accreditor Actions – probation, show-cause, or other equivalent or greater action	Accreditor takes action on institution	Accreditor issues a show-cause order that, if not resolved, would result in the loss of institutional accreditation.	Limits trigger to accreditor actions that could lead to loss of institutional accreditation and/or closure of the school

Financial Responsibility Trigger	2016 Regulation	Proposed Regulation	Change Summary
Security or Loan Agreement violations	Creditor requires an increase in collateral, a change in contractual obligations, an increase in interest rates or payments, or other sanctions, penalties, or fees	Creditor requires an increase in collateral, a change in contractual obligations, an increase in interest rates or payments, or other sanctions, penalties, or fees	No Change
Cited for Failing State licensing or authorizing agency requirements	Notified of noncompliance with any provision	Notified of noncompliance relating to termination or withdrawal of licensure or authorization if institution does not take corrective action	Reduced liability
Significant Fluctuations in Pell Grant and Direct Loan funds	Changes in consecutive award years, or over a period of award years, not due to title IV program changes	Removed	None because consecutive year-over-year award levels were never evaluated
Financial Stress Test developed or adopted by the Secretary	• Institution fails the test • Specific stress test never proposed or developed	Removed	None because test never created
High Drop-Out Rates, as defined by the Secretary	• Institution has high annual drop-out rate Specific threshold never developed	Removed	None because threshold never set
Anticipated Borrower Defense Claims	Secretary predicts claims as a result of a lawsuit, settlement, judgment, or finding from a State or Federal administrative proceeding	Removed	Reduced Liability

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Some institutions may incur burden from the requirement to report any action or event described in § 668.171(e) within the specified number of days after the action or event occurs. As further explained in the *Paperwork Reduction Act of 1995* section, the Department estimates the burden for reporting these events to the Secretary would be 720 hours annually for private schools and 2,274 hours for proprietary institutions for a total burden of 2,994 hours. Using an hourly rate of $44.41,[21] we estimate that the costs incurred by this regulatory change would be $132,964 annually ($44.41*2,994).

[21] Hourly wage data uses the Bureau of Labor Statistics, available at *swww.bls.gov/ooh/management/postsecondary-education-administrators.thm.*

FASB is a standard-setting body that establishes generally accepted accounting principles and the Department requires that institutions participating in the title IV, HEA programs file audited financial statements annually, with the audits performed under FASB standards. Therefore, financial statements will begin to contain elements that are either

new or reported differently, including long-term lease liabilities. These changes were not included in the 2016 regulations and are new to these proposed regulations.

Changes in the definition of terms used under the financial responsibility standards are being proposed to align the regulations with current FASB standards.[22] However, the new FASB lease standard could have a profound impact on an institution's composite score and the Department has no mechanism to make a timely adjustment to the composite score calculation to accommodate this change. The Department also has no data to understand what the impact of this change will be on institutional composite scores. Models were created in SAS [23] to perform impact and sensitivity analyses on the proposed changes to the composite score calculations. However, the Department does not have structured data for these 12 values used in the calculation:

- Lease Right-of-use Assets (VAR1);
- Lease Right-of-use Liabilities (VAR2);
- Net Assets With Donor Restrictions (VAR3);
- Net Assets Without Donor Restrictions (VAR4);
- Net Assets With Donor Restrictions: Restricted in Perpetuity (VAR5);
- Post–employment and defined benefit pension plan liabilities (VAR6);
- Loss for defined pension and other post-employment, investments and annuities (VAR7);
- Investment Gains (VAR8);
- Non-operating investment amount needed for separation of expenses (VAR9);
- Annuities, term endowments and life funds not restricted in perpetuity (VAR10);
- Construction in process (VAR11); and
- Debt purpose and related amount (VAR12).

The Department invites commenters to submit data to the Department on these variables. Specific, numeric values submitted will be considered for inclusion in the Department's models prior to publication of the final regulations. We invite submission of data at the institutional level as well as means or medians. Please submit data in the format provided in Tables 3 and 4 (data without OPEID will also be accepted).

TABLE 3—FINANCIAL DATA FOR PROPRIETARY INSTITUTIONS

OPEID	VAR1	VAR2	VAR3	VAR4	VAR5	VAR6	VAR7	VAR8	VAR9	VAR10	VAR11	VAR12
Median												
Mean												

TABLE 4—FINANCIAL DATA FOR NONPROFIT INSTITUTIONS

OPEID	VAR1	VAR2	VAR3	VAR4	VAR5	VAR6	VAR7	VAR8	VAR9	VAR10	VAR11	VAR12
Median												
Mean												

Therefore, while the Department must obtain audited financial statements prepared in accordance with FASB standards, and it will automatically calculate a composite score for all institutions using the audited financial statements, those institutions that wish to have an alternative composite score calculated based on the current methodology (minus long term lease liabilities) can provide supplemental data to the Department and request the alternative score to be calculated. The Department will use the higher of the two scores to determine an institution's financial responsibility. Under this proposal, an institution can continue to rely on long-term leases that reduce costs, increase campus stability and prevent increased school closures that result from short-term leases that cannot be extended or satisfactorily renegotiated.

The Department may use the data it would collect under the proposed regulations to conduct analyses that might inform future negotiated rulemaking to update the composite score methodology. As explained further in the *Paperwork Reduction Act of 1995* section, 1,896 proprietary institutions and 1,799 private institutions will each need 1 hour annually to prepare a Supplemental Schedule to post along with their annual audit ((1,896+1,799) × 1 hour × $44.41). This will result in an additional annual burden of $164,095. Further, 450 private institutions and 474 proprietary institutions would each need 15 minutes to request that the Secretary make the second composite score calculation, for an additional annual burden of $10,303. The Department is not yet receiving these data on

[22] *www.fasb.org/jsp/FASB/Page/LandingPage&cid=1175805317350.*

[23] SAS Software. SAS Institute Inc. SAS and all other SAS Institute Inc. product or service names are registered trademarks or trademarks of SAS Institute Inc., Cary, NC, USA.

institutions' financial statements, so it is unable to quantify anticipated changes. We invite data submissions in this section for the Department to use in composite score sensitivity analyses. If the Department receives a sufficient number of complete data submissions, it may include this sensitivity analysis in the RIA in the final regulations.

5. Enrollment Agreements

The proposed regulations would permit institutions to include mandatory arbitration clauses and class action waivers in enrollment agreements they have with students receiving title IV financial aid. These provisions were prohibited by the 2016 regulations. The recent Supreme Court decision in *Epic Systems Corp.* v. *Lewis,* 584 U.S.____, 2018 WL 2292444 (May 21, 2018) held that arbitration clauses in employment contracts must be enforced by the courts as written, in essence confirming the right of private parties to sign contracts that compel arbitration and waive class action rights. Institutions may benefit from arbitration in that it is a faster and less expensive way to resolve disputes, while reducing reputational effects; however, they may incur costs resulting from an increased use of arbitration under the proposed regulations. Students may also benefit from arbitration, which is easier and less costly to navigate. On the other hand, students will have reduced access to a judicial forum, which would decrease the ability of a borrower to hold the institution publicly accountable.

6. Institutional Disclosures

Some institutions will incur costs under the proposed disclosure requirements. Institutions that include mandatory pre-dispute arbitration clauses or class action waivers in their enrollment agreements would be required to make certain disclosures. As further explained in the *Paperwork Reduction Act of 1995* section, the Department estimates the burden for making these disclosures would affect 944 proprietary institutions for a total of 4,720 hours annually. Using an hourly rate of $44.41,[24] we estimate the costs incurred by this regulatory change would be $209,615. Also as discussed in the *Paperwork Reduction Act of 1995* section, we estimate these same institutions would be required to include this information to borrowers during entrance counseling, for a further burden of 3 hours each annually, totaling $125,769 annually (944*3*44.41). Therefore, we estimate the total burden for disclosures would be $335,384 annually ($209,615 + $125,769).

3. Guaranty Agencies

Guaranty agencies would incur one-time costs as well as annual costs under the proposed regulations. The one-time costs would be to update their systems to identify borrowers now eligible for closed school discharges for reporting to lenders and to update their notifications and establish a process for forwarding requests for escalated reviews to the Secretary. As further explained in the *Paperwork Reduction Act of 1995* section, the Department estimates the burden for making these system changes would be 336 hours (240+96). Using an hourly rate of $44.41,[25] we estimate costs incurred by this regulatory change would be $14,921.76 (336 hours * $44.41 per hour). Finally, there would be an ongoing, annual burden on guaranty agencies to forward a borrower's request for escalated review of a denied closed school discharge to the Secretary. We estimate this burden would be 74 hours annually. Using the same hourly rate, we estimate costs incurred by this regulatory change would be $3,286.34 (74 hours * $44.41 per hour). Therefore, the Department estimates increased costs to guaranty agencies of $3,286 annually and $14,922 additional one-time costs in the first year.

The Department does not have data on interest capitalization and collection costs for rehabilitated loans to estimate the impact of the changes in the proposed regulations. The Department invites commenters to submit the following data points: proportion of rehabilitated loans where collection costs were charged, mean collection costs charged under this circumstance per loan, proportion of rehabilitated loans where interest is capitalized prior to sale, and mean interest capitalized under this circumstance per loan.

3. Federal Government

These proposed regulations would affect the Federal government's administration of the title IV, HEA programs. The Federal government would benefit in several ways, including significant reductions in student loan discharge transfers, reduced administrative burden, increased (or at least steady) public confidence in the student loan program, and increased access to data. The Federal government would incur costs to update its IT systems to implement the proposed changes.

a. Borrower Defenses

Borrower defense to repayment was described in the 1994 regulations promulgated by the Department as a right that a borrower could exercise once involved in a collections proceeding. The Department altered this approach in 2015 by allowing borrowers to file affirmative borrower defense claims, meaning claims while loans are in repayment or forbearance, and the 2016 regulations continued that approach. The proposed regulations would return to accepting defensive claims only, transferring the cost burden of misrepresentation back to institutions and the cost of administering consumer fraud allegations to the appropriate entities—courts or arbitration. It is more likely that the cost of misrepresentation would be incurred by institutions committing the act or omission than the taxpayer, because borrowers would be encouraged first to go to the institution to litigate claims of misrepresentation and because the Department would recoup defense to repayment discharge transfers from institutions.

In addition, although not quantifiable, a Federal student loan program that does not result in additional financial burden to the taxpayer is likely to be more stable and viable over the long term, and therefore more likely to continue receiving Congressional and taxpayer support. Therefore, restoring defense to repayment as a last resort option rather than a first resort consumer protection mechanism will likely ensure that the student loan program continues to serve borrowers into the future.

Finally, the Department expects a marked reduction in administrative burden as a result of the proposed changes to the circumstances under which it would consider a borrower's defense to repayment application. While the proposed regulations would rely heavily upon existing collection processes to initiate a defense against collection actions, the Department has also requested public comment on how affirmative claims might be adjudicated and how sufficient guardrails could be put in place to minimize the submission of unjustified claims or those that do not fall within the scope of a defense to repayment claim. Thus, until the final determination is made regarding the Department's acceptance of affirmative claims, defensive claims, or both, it is unable to provide an estimate of this reduction in adjudication burden.

[24] Hourly wage data uses the Bureau of Labor Statistics, available at *www.bls.gov/ooh/management/postsecondary-education-administrators.thm.*

[25] Hourly wage data uses the Bureau of Labor Statistics, available at *www.bls.gov/ooh/management/postsecondary-education-administrators.thm.*

b. Loan Discharges

Under the proposed regulations, the Department would expect to process and award fewer closed school and false certification loan discharges than it would have under the 2016 regulations. To the extent defense to repayment, closed school, and false certification loan discharges are not reimbursed by institutions, Federal government resources that could have been used for other purposes will be transferred to affected borrowers. As further detailed in the *Net Budget Impacts* section, the Department estimates that annualized transfers from the Federal government to affected borrowers, partially reimbursed by institutions, would be reduced by $693.9 million for borrower defenses and $96.5 million for closed school discharges with reductions in reimbursement from institutions of $223 million annually. This is based on the difference in cashflows associated with loan discharges when the proposed regulation is compared to the President's Budget 2019 baseline (PB2019) and discounted at 7 percent.

c. Financial Responsibility Standards

The Department will benefit from receiving updated financial statements consistent with FASB standards. By receiving information to calculate both composite scores, the Department would have data necessary for developing updated composite score regulations through future rulemaking. The financial responsibility disclosures will enable the Department to receive information to continue to calculate the composite score.

The Department would incur one-time costs for modifying eZ-Audit and other systems to collect the data needed to calculate composite scores under the new FASB reporting requirements and other systems to collect financial responsibility disclosures. The Department has not yet conducted the Independent Government Cost Estimate (IGCE) to determine the costs for making these system changes. Further, the Department expects ongoing, increased administrative burden because it would need to compute two composite scores for each institution under the proposed regulations. However, the Department has not yet developed its internal process for implementing the proposed regulations, which may necessitate a software modification or individually-generated calculations; consequently, it is unable to estimate the change in administrative burden. Therefore, the Department is unable to estimate its burden for implementing the proposed regulatory changes in the financial responsibility provisions.

Net Budget Impacts & Accounting Statement

These proposed regulations are estimated to have a net Federal budget impact over the 2019–2028 loan cohorts of $[−12.715] billion in the primary estimate scenario, including $[−10.487] billion for changes to the defense to repayment provisions and $−2.227 billion for changes related to closed school discharges. A cohort reflects all loans originated in a given fiscal year. Consistent with the requirements of the Credit Reform Act of 1990, budget cost estimates for the student loan programs reflect the estimated net present value of all future non-administrative Federal costs associated with a cohort of loans. The Net Budget Impact is compared to the 2019 President's Budget baseline (PB2019). This baseline assumed that the borrower defense regulations published by the Department on November 1, 2016, would go into effect in 2019 and utilized the primary estimate scenario,[26] as modified by the change in the effective date to 2019, described in the final rule published February 14, 2018.[27]

The proposed regulatory provisions with the greatest impact on the Federal budget are those related to the discharge of borrowers' loans. Borrowers may pursue closed school, false certification, or defense to repayment discharges. The precise allocation across the types of discharges will depend on the borrower's eligibility and ease of pursuing the different discharges, and we recognize that some applications may be fluid in classification between defense to repayment and the other discharges. In this analysis, we assign any estimated effects from defense to repayment applications to the defense to repayment estimate and the remaining effects associated with eligibility and process changes related to closed school discharges to the closed school discharge estimate.

1. Defense to Repayment Discharges

As noted previously, the Department had to incorporate the changes to the defense to repayment provisions related to the 2016 final regulations into its ongoing budget estimates, and changes described here are evaluated against that baseline. In our main estimate, based on the assumptions described in Table 5, we present our best estimate of the impact of the changes to the defense to repayment provisions in the proposed regulation.

a. Assumptions and Estimation Process

The net present value of the reduced stream of cash flows compared to what the Department would have expected from a particular cohort, risk group, and loan type generates the expected cost of the proposed regulations. We applied an assumed level of school misconduct, defensive claims, defense to repayment applications success, and recoveries from institutions (respectively labeled as Conduct Percent, Defensive Claims Percent, Borrower Percent, and Recovery Percent in Table 5) to loan volume estimates to generate the estimated net number of borrower defense applications for each cohort, loan type, and sector. Table 5 presents the assumptions for the main budget estimate with the budget estimate for each scenario presented in Table 6. We also estimated the impact if the Department received no recoveries from institutions, the results of which are discussed after Table 6.

The model can be described as follows: To generate gross applications (gc), loan volumes (lv) by sector were multiplied by the Conduct Percent (cp), the Defensive Applications Percent (dcp) and the Borrower Percent (bp); to generate net applications (nc) processed in the Student Loan Model, gross applications were then multiplied by the Recovery Percent (rp). That is, gc = (lv * cp * dcp * bp) and nc = gc − (gc * rp). The Conduct Percent represents the share of loan volume estimated to be affected by institutional behavior resulting in a defense to repayment application. The Borrower Percent captures the percent of loan volume associated with approved defense to repayment applications, and the Recovery Percent estimates the percent of net loans eventually discharged. The numbers in Table 5 are the percentages applied for the main estimate and PB2019 baseline scenarios for each assumption for cohorts 2019–2028.

[26] See 81 FR 76057 published November 1, 2016, available at *ifap.ed.gov/fregisters/attachments/FR110116.pdf.*

[27] See 83 FR 6468, available at *www.gpo.gov/fdsys/pkg/FR-2018-02-14/pdf/2018-03090.pdf.*

TABLE 5—ASSUMPTIONS FOR MAIN BUDGET ESTIMATE COMPARED TO PB2019 BASELINE

Cohort	PB2019 baseline			NPRM main		
	Pub	Priv	Prop	Pub	Priv	Prop
Conduct Percent						
2019	1.8	1.8	12.24	1.71	1.71	11.63
2020	1.7	1.7	11.6	1.62	1.62	11.02
2021	1.5	1.5	9.8	1.43	1.43	9.31
2022	1.4	1.4	8.8	1.33	1.33	8.36
2023	1.3	1.3	8.4	1.24	1.24	7.98
2024	1.2	1.2	8	1.14	1.14	7.6
2025	1.2	1.2	7.8	1.14	1.14	7.41
2026	1.1	1.1	7.7	1.05	1.05	7.32
2027	1.1	1.1	7.7	1.05	1.05	7.32
2028	1.1	1.1	7.7	1.05	1.05	7.32
	2Yr pub/priv	2Yr prop	4Yr pub/priv	4Yr prop		
Defensive Applications Percent (not in PB2019 Baseline)						
All Cohorts	40	34	16	21	.....	.....

Cohort	PB2019 baseline			NPRM main		
	Pub	Priv	Prop	Pub	Priv	Prop
Borrower Percent						
2019	36.8	36.8	47.3	4	4	6
2020	42.4	42.4	54.6	4.4	4.4	6.6
2021	46.7	46.7	60	5	5	7.3
2022	50	50	63	5.5	5.5	7.9
2023	50	50	65	6	6	8.4
2024	50	50	65	6.4	6.4	9
2025	50	50	65	7	7	9.3
2026	50	50	65	7	7	10
2027	50	50	65	7	7	10
2028	50	50	65	7	7	10
Recovery Percent						
2019	75	24.871	24.871	75	16	16
2020	75	28.8	28.8	75	16	16
2021	75	31.68	31.68	75	18.5	18.5
2022	75	33.26	33.26	75	18.5	18.5
2023	75	34.93	34.93	75	21	21
2024	75	36.67	36.67	75	21	21
2025	75	37.4	37.4	75	22.5	22.5
2026	75	37.4	37.4	75	22.5	22.5
2027	75	37.4	37.4	75	25	25
2028	75	37.4	37.4	75	25	25

As in previous estimates, the recovery percentage reflects the fact that public institutions are not subject to the changes in the financial responsibility triggers because of their presumed backing by their respective States. Therefore, the PB2019 baseline and main recovery scenarios are the same for public institutions and set at a high level to reflect the Department's confidence in recovering amounts from the expected low number of claims against public institutions. The decrease in the recovery percentage assumption for private and proprietary institutions compared to the PB2019 baseline reflects the removal or modification of some financial responsibility triggers as described in Table 2. We do not specify how many institutions are represented in the estimate as the assumptions are based on loan volumes and the scenario could represent a substantial number of institutions engaging in acts giving rise to defense to repayment applications or could represent a small number of institutions with significant loan volume subject to a large number of applications. According to Federal Student Aid data center loan volume reports, the five largest proprietary institutions in loan volume received 24.59 percent of Direct Loans disbursed in the proprietary sector in award year 2016–17 and the 50 largest proprietary institutions represent 66.6 percent of Direct Loans disbursed in that same time period.[28] The share of volume captured in the conduct percentage may be conservative and estimate a higher number of defense to repayment applications than may occur in the future as we did not want to underestimate costs associated with changes to the borrower defense regulations. Due to the similarities between the conduct covered by the standard in the proposed regulations and the standard in the 2016 final regulations, as described in the *Discussion* segment, the Conduct Percent did not change from the PB2019 Baseline as much as the Borrower Percent. As recent loan cohorts progress further in their repayment cycles if

[28] Federal Student Aid, Student Aid Data: Title IV Program Volume by School Direct Loan Program AY2015–16, Q4, available at *studentaid.ed.gov/sa/about/data-center/student/title-iv* accessed August 22, 2016.

future data indicate that the percent of volume affected by conduct that meets the standard that would give rise to defense to repayment applications differs from current estimates, that difference will be reflected in future baseline re-estimates.

b. Discussion

The Department has some additional experience with processing defense to repayment applications and data on the approximately 138,990 applications received since 2015, but while this information has helped inform these estimates, it does not eliminate the uncertainty about institutional and borrower response to the proposed regulations. As noted earlier, given the limited number of applications that the Department has adjudicated, both in number and sector of institutions that are represented in this number, our data may not reflect the final results of the Department's review and approval process.

By itself, the proposed Federal standard is not expected to significantly change the percent of loan volume subject to conduct that might give rise to a borrower defense claim. The conduct percent is assumed to be 95 percent of the PB2019 baseline level.

As has been estimated previously, we are incorporating a deterrent effect of the borrower defense to repayment provisions on institutional behavior as is reflected in the decrease in the conduct percent in Table 5. We believe that institutions will not want to suffer the scrutiny that a significant number of borrower defense to repayment applications would invite. As expected, when regulatory provisions target specific institutional action or performance, institutional behavior changes over several years, resulting in removal of the worst performers and adaptation of other institutions' behavior so that a lower steady state is established. We still expect a similar pattern to develop with respect to borrower defense to repayment, as reflected in the Conduct Percent in Table 5. Also, allowing institutions to present evidence may result in fewer findings of misrepresentation that lead to an adjudicated claim. We have not included the impact of this potential evidence in our calculations as we have no basis for determining the impact that an institutional defense will have on the adjudication of applications.

Overall, we expect that the changes in the proposed regulations that will reduce the anticipated number of borrower defense applications are related more to changes in the process and emphasis on defensive claims, not due to changes in the type of conduct on the part of an institution that would result in a successful defense, as demonstrated by the 95 percent overlap compared to the PB2019 baseline.

The proposed regulations reestablish a framework in which borrower defense to repayment applications are submitted in response to certain collection activities initiated by the Department, specifically administrative wage garnishment, Treasury offset, credit bureau default reporting, and Federal salary offset. As has always been the case, borrowers will be able to seek relief from their institutions in State or Federal courts or from State or Federal agencies, and the inclusion of mandatory arbitration clauses in enrollment agreements may increase financial settlements with students, but defense to repayment applications through the Department will be reserved as a defense to collection efforts. The Defensive Applications Percent attempts to quantify the effect of this proposal by examining estimated lifetime default rates for loans in standard repayment plans by SLM risk group. The 2-year not for profit risk group was used for the 2-year or less private and public sectors, and the 2-year proprietary risk group was used for the 2-year proprietary sector. For 4-year institutions, the 4-year freshman/sophomore risk group rate was used for 4-year proprietary schools, and the weighted average of the 4-year freshman/sophomore and 4-year junior/senior rates were used for 4-year public and private nonprofit institutions. The estimated default rates were used to estimate the percent of loan volume associated with borrowers who, over the life of the loan, might be in a position to raise a defense to repayment. We used the higher estimated default rates associated with the standard repayment plan so that we did not underestimate potential future costs of the proposed defense to repayment regulations. Using the higher rates also accounts for the possibility of increased defaults by borrowers who may decide that the consequences of default are worth the risk of a potentially successful defense to repayment applications. However, now that institutions have the ability to present evidence as borrowers' applications are considered, there may be a decrease in frivolous and unsubstantiated defense to repayment applications that, under current practice, could be approved.

Several process changes contribute to the reduction in the Borrower Percent compared to the PB2019 baseline assumption. A separate assumption for the defensive claims provision was explicitly included so it could be varied in sensitivity runs or in response to comments. Another significant factor is the emphasis on determinations of individual applications and the lack of an explicit process for aggregating like applications. The Department will be able to group like applications against an institution for more efficient processing, but, even if there is a finding that covers multiple borrowers, relief will be determined on an individual basis and be related to the level of financial harm proven by the borrower. Additionally, while there is no statute of limitations on borrowers' ability to submit a defense to repayment application in response to collection activities, borrowers will have to inform the Department of their intent to raise a defense to repayment within the timeframe specified for requesting a hearing in their notice of collection activity to guarantee their filing will be reviewed. The timeframes vary from 30 days for consumer reporting and wage garnishment to 65 days for Federal salary offset and tax refund offset. Together, these changes could require more effort on the part of individual borrowers to submit a borrower defense application, which is reflected in the change in the Borrower Percent assumption.

The net budget impact of the emphasis on other avenues for relief is complicated by the potential for amounts received in lawsuits, arbitration, or agency actions to reduce the amount borrowers would be eligible to receive through a defense to repayment filing. While it would be prudent for borrowers to use any funds received with respect to the Federal loans in such proceedings to pay off the loans, there is no mechanism in the proposed regulations to require this. This offset of funds received in other actions was also a feature in the 2016 final regulations, but the majority of applications processed did not have offsetting funds to consider due to the precipitous closure of two large institutions. Accordingly, we are not assuming a budgetary impact resulting from prepayments attributable to the possible availability of funds from judgments or settlement of claims related to Federal student loans. Another factor that could affect the number of defense applications presented is the role of State Attorneys General or State agencies in pursuing actions or settlements with institutions about which they receive complaints. The level of attention paid to this area of consumer protection could alert borrowers in a position to apply for a defense to repayment and result in a

different number of applications than the Department anticipates. Evidence developed in such proceedings could be used by borrowers to support their individual applications.

The Department has used data available on defense to repayment applications, associated loan volumes, Departmental expertise, the discussions at negotiated rulemaking, information about past investigations into the type of institutional acts or omissions that would give rise to defense to repayment applications, and decisions of the Department to create new sanctions and apply them to institutions thus instigating precipitous closures to develop the main estimate and sensitivity scenarios that we believe will capture the range of net budget impacts associated with the defense to repayment regulations.

c. Additional Scenarios

The Department recognizes the uncertainty associated with the factors contributing to the main budget assumption presented in Table 5. The uncertainty in the defense to repayment estimate, given the unknown level of future school conduct that could give rise to claims; institutions' reaction to the regulations to eliminate such activities; the impact of allowing institutions to present evidence in response to borrowers' applications; the extent of full versus partial relief granted; and the level of State activity, is reflected in additional analyses that demonstrate the effect of changes in the specific assumption being tested.

The Department designed the following scenarios to isolate the assumption being evaluated and adjust it in the direction that would increase costs, increasing the Defensive Applications or Borrower Percent and decreasing the recovery percent. The first scenario the Department considered is that the Defensive Applications Percent will increase by 15 percent (Def15). This could occur if economic conditions or strategic behavior by borrowers increase defaults. The second scenario the Department increased the Borrower Percent by 20 percent (Bor20) to reflect the possibility that outreach, model applications, or other efforts by students may increase the percent of loan volume associated with successful defense to repayment applications. As the gross borrower defense claims are generated by multiplying the estimated volumes by the Conduct Percent, Defensive Claims Percent, and the Borrower Percent, the scenarios capture the impact of a 15 percent or 20 percent change in any one of those assumptions. The Recovery Percentage is applied to the gross claims to generate the net claims, so the RECS scenario reduces recoveries by approximately 36 percent to demonstrate the impact of that assumption. The Department also estimated the effect of allowing affirmative claims by removing the Defensive Claims Percent (Affirmative Claims Allowed scenario) which reduced savings by approximately $960 million when estimated on top of the other changes in the proposed regulations. The net budget impacts of the various additional scenarios compared to the PB2019 baseline range from $ − 9,528 billion to $ − 10,452 billion and are presented in Table 6.

TABLE 6—BUDGET ESTIMATES FOR ADDITIONAL BORROWER DEFENSE SCENARIOS

Scenario	Estimated costs for cohorts 2019–2028 (outlays in $mns)
Main Estimate	$ − 10,487
Def15	− 10,452
Bor20	− 10,445
Recs	− 10,459
Affirmative Claims Allowed	− 9,528

The transfers among the Federal government, affected borrowers, and institutions associated with each scenario above are included in Table 7, with the difference in amounts transferred to borrowers and received from institutions generating the budget impact in Table 6. The amounts in Table 6 assume the Federal Government will recover from institutions some portion of amounts discharged. In the absence of any recovery from institutions, taxpayers would bear the full cost of approved defense to repayment applications. For the primary budget estimate, the annualized costs with no recovery are approximately $635.7 million at a 3 percent discount rate and $693.9 million at a 7 percent discount rate. This potential increase in costs demonstrates the effect that recoveries from institutions have on the net budget impact of the proposed defense to repayment regulations.

The Department may revise its model related to these provisions as more data become available over time. We welcome comments on the Defense to Repayment Discharge model, its assumptions, and its conclusions; the Department may incorporate well-documented comments into this model as we develop the final regulations.

2. Closed School Discharges

In addition to the provisions previously discussed, the proposed regulations also would make three changes to the closed school discharge process that are expected to have an estimated net budget impact of − $2.227 billion, of which − $359 million is a modification to cohorts 2014–2018 related to the elimination of the automatic 3-year discharge. The combined effect of the elimination of the 3-year automatic discharge, the limitation to students not offered a teach-out opportunity approved by the school's accrediting agency and the school's State authorizing agency, and the expansion of the eligibility window to 180 days is − $1.868 billion for cohorts 2019–2028. As with the estimates related to the borrower defense to repayment provisions, the net budget impact estimates for the closed school discharge provisions are developed from the PB2019 budget baseline that accounted for the delayed implementation of the 2016 final regulations and assumed the 2016 final regulations would take effect on July 1, 2019.

While the Secretary will retain the discretion to approve closed school discharges without applications, the standard path to such a discharge will require borrowers to submit an application. The Department does, however, plan to be more aggressive in informing students who are eligible for closed school discharges of their rights. In CY2015 to CY2017, closed school discharges excluding Corinthian and ITT ranged from 24.2 million to $69.9 million annually. Therefore, the savings from eliminating the 3-year automatic closed school discharge provisions offset the costs of expanding the eligibility window to 180 days for cohorts 2019–2028. The precise interaction between the two effects is uncertain as outreach and better information for borrowers about the closed school discharge process may increase the rate of borrowers who submit applications. In estimating the effect of the 2016 final regulations, the Department looked at all Direct Loan borrowers at schools that closed from 2008–2011 to see the percentage loan volume associated with borrowers that had not received a closed school discharge and had no NSLDS record of title-IV aided enrollment in the three years following their school's closure and found it was approximately double the amount of those who received a discharge. This could be because the students received a teach-out or transferred credits and completed

without additional title IV aid, or it could be that the students did not apply for the discharge because of a lack of awareness or other reasons. Whatever the reason, in estimating the potential cost of the 3-year automatic discharge provision in the PB2019 baseline, the Department applied this increase to the closed school discharge rate. For these proposed regulations, we have reversed the increase attributed to the 3-year automatic discharge.

The volume of additional discharges that might result from the expansion of the window is also difficult to predict. The Department analyzed borrowers who were enrolled within 180 days of the closure date for institutions that closed between July 1, 2011 and February 13, 2018 and found that borrowers who withdrew within the 121 to 180 day time frame would increase loan volumes eligible for discharge by approximately nine percent. However, it is possible that some borrowers who complete their programs in that window or the current 120 day window for eligibility would choose to withdraw and pursue a closed school discharge instead of completing if the school closure is known in advance. The likelihood of this is unclear as it might depend on the relative length of the program, the time the borrower has remaining in the program, and the borrower's perception of the value of the credential versus the burden of starting the program over again as compared to the prospect of debt relief. Further, if the student knows that the school plans to close, it is likely because the school has implemented a teach-out plan, which would negate the borrower's ability to claim a closed school discharge if the institution fulfilled the plan. For these reasons, and especially the potential effect of the teach-out provision, the Department did not adjust for this factor in estimating the impact of the expansion of the eligibility window, but welcomes comments on the likelihood of its impacts and will consider those comments in developing estimates of the impact of the final regulations.

While the expansion of the eligibility window and the elimination of the three-year automatic discharge provisions allow for borrower decisions to affect the number of closed school discharges, the proposal to add to the existing limitation on students who transferred credits and completed the program at another institution limits the availability of closed school discharges to borrowers not offered a reasonable approved, teach-out opportunity and places key eligibility factors in the hands of institutions. This makes closed school discharges a form of relief for borrowers who were enrolled at an institution that closed precipitously, decided implementation of a teach-out plan was not practical or worth the expense for some or all students, or failed to implement an approved plan. The Department's requirements that accreditors review and evaluate teach-out plans that must be submitted by institutions under certain circumstances emphasizes the importance of teach-out plans in serving the best interests of students. The Department expects that this proposed change could further reduce closed school discharges, but our data do not provide sufficient information to know if any of the past closed school discharges were awarded to students who were also provided with a reasonable teach-out opportunity. Students who took advantage of such activities would have completed their program, and therefore would not be eligible for a closed school discharge, including under the current regulation. It could be that the number of closed school discharges is relatively low (as compared with the potential pool of borrowers eligible) because most institutions provide a teach-out opportunity that allows the borrower to complete his or her program. To the extent many borrowers are currently completing teach-outs, the cost impact of the teach-out limitation may be minimal.

The proposed regulations provide incentives for institutions to offer teach-outs so as to provide students the opportunity to complete their programs. To capture this effect, the Department reduced baseline closed school discharges by 65 percent. As is demonstrated by the estimated net savings from the closed school discharge changes, the removal of the three-year automatic discharge provisions and the change in eligibility to those offered an approved teach-out plan are expected to reduce the anticipated closed school discharge claims significantly more than the expansion of the window to 180 days increases them. In other words, the proposed regulations provide an incentive for institutions rather than students or taxpayers to bear the cost and burden of a closed school. In some scenarios, such as the precipitous closure of large institutions, the expansion of the window to 180 days could increase closed school discharges more than the other provisions reduce them, but the Department does not consider such a scenario to be likely. The Department welcomes comments on the assumptions used in estimating the net budget impact of the closed school discharge provisions, especially information on the frequency of teach-outs offered.

3. Other Provisions

The proposed regulations will also make a number of changes that are not estimated to have a significant net budget impact including changes to the financial responsibility standards and treatment of leases, false certification discharges, guaranty agency collection fees and capitalization, and the calculation of the borrower's subsidized usage period process. The false certification discharge changes update the regulations to reflect current practices. The proposed regulations would also provide that borrowers who provide a written attestation of high school completion in place of an unavailable high school diploma would be ineligible for a false certification discharge. In FY2017, false certification discharges totaled approximately $7 million. As before, we do not expect a significant change in false certification discharge claims that would result in a significant budget impact from this change in terms or use of an application that has been available at least ten years in place of a sworn statement. False certification discharges may decrease due to the ineligibility of borrowers who submit a written attestation in place of a high school diploma, but given the low level of false certification discharges in the baseline, even if a large share were eliminated, it would not have a significant net budget impact. Therefore, we do not expect an increase in false certification discharge claims or their associated discharge value.

Some borrowers may be eligible for additional subsidized loans and no longer be responsible for accrued interest on their subsidized loans as a result of their subsidized usage period being eliminated or recalculated because of a closed school, false certification, unpaid refund, or defense to repayment discharge. As in the 2016 final regulations, we believe the institutions primarily affected by the 150 percent subsidized usage regulation are not those expected to generate many of the applicable discharges, so this reflection of current practice is not expected to have a significant budget impact.

4. Accounting Statement

As required by OMB Circular A–4 we have prepared an accounting statement showing the classification of the expenditures associated with the provisions of these regulations (see Table 7). This table provides our best

estimate of the changes in annual monetized transfers as a result of these proposed regulations. The amounts presented in the Accounting Statement are generated by discounting the change in cashflows related to borrower discharges for cohorts 2019 to 2028 from the PB2019 baseline at 7 percent and 3 percent and annualizing them. This is a different calculation than the one used to generate the subsidy cost reflected in the net budget impact, which is focused on summarizing costs at the cohort level. As the life of a cohort is estimated to last 40 years, the discounting does have a significant effect on the impact of the difference in cashflows in the outyears. Expenditures are classified as transfers from the Federal Government to affected student loan borrowers.

TABLE 7—ACCOUNTING STATEMENT: CLASSIFICATION OF ESTIMATED EXPENDITURES
(In millions)

Category	Benefits	
Disclosure to borrowers about use of mandatory pre-dispute arbitration clauses and potential increase in settlements between borrowers and institutions.	Not quantified.	
Reduced administrative burden related to processing defense to repayment applications	Not quantified.	
Category	**Costs**	
	7%	3%.
Cost of compliance with paperwork requirements	1.15	1.16.
Changes in Department's systems to collect relevant information and calculate revised composite score	Not Quantified.	
Category	**Transfers**	
	7%	3%.
Reduced defense to repayment discharges from the Federal Government to affected borrowers (partially borne by affected institutions, via reimbursements.	$693.9	$635.7.
Reduced reimbursements of borrower defense claims from affected institutions to affected student borrowers, via the Federal government.	$223	$205.
Reduced closed school discharges from the Federal Government to affected borrowers	$96.5	$61.9.

Previous Accounting Statements by the Department, including for the 2016 final regulations, presented a number that was the average cost for a single cohort. If calculated in that manner, the reduced transfers for defense to repayment from the Federal government to affected borrowers would be $ − 1,448 million, reimbursements would be reduced $ − 414 million, and closed school discharge transfers would be reduced $ − 233 million at a 7 percent discount rate.

D. Regulatory Flexibility Act

The U.S. Small Business Administration (SBA) Size Standards define proprietary institutions as small businesses if they are independently owned and operated, are not dominant in their field of operation, and have total annual revenue below $7,000,000. Nonprofit institutions are defined as small entities if they are independently owned and operated and not dominant in their field of operation. Public institutions are defined as small organizations if they are operated by a government overseeing a population below 50,000.

The Department's eZ-Audit data shows that there were 1,522 Title IV proprietary schools with revenue less than $7,000,000 for the 2015–2016 Award Year.[29] However, the Department lacks data to identify which public and private, nonprofit institutions qualify as small. Given the data limitations, the Department proposes a data-driven definition for ''small institution'' in each sector and uses its proposed definition to certify the RFA impacts of the proposed rule.

1. Proposed Definition

The Department has historically assumed that all private nonprofit institutions were small because none were considered dominant in their field. However, this approach masks significant differences in resources among different segments of these institutions. The Department proposes to use enrollment data for its definition of small institutions of postsecondary education. Prior analyses show that enrollment and revenue are correlated for proprietary institutions. Further, enrollment data are readily available to the Department for every postsecondary institution while revenue is not. The Department analyzed a number of data elements available in IPEDS, including Carnegie Size Definitions, IPEDS institutional size categories, total FTE, and its own previous research on proprietary institutions referenced in ED–2017–OPE–0076i. As a result of this analysis, the Department proposes to use this definition to define small institutions:

- Two-year IHEs, enrollment less than 500 FTE; and
- Four-year IHEs, enrollment less than 1,000 FTE.

Table 8 shows the distribution of small institutions under this proposed definition using the 2016 IPEDS institution file.[30]

TABLE 8—SMALL INSTITUTIONS UNDER PROPOSED DEFINITION

Level	Type	Small	Total	Percent
2-year	Public	342	1,240	28
2-year	Private	219	259	8
2-year	Proprietary	2,147	2,463	87
4-year	Public	64	759	8
4-year	Private	799	1,672	48

[29] *studentaid.ed.gov/sa/about/data-center/school/proprietary* (extracted from eZ-Audit on June 30, 2017)

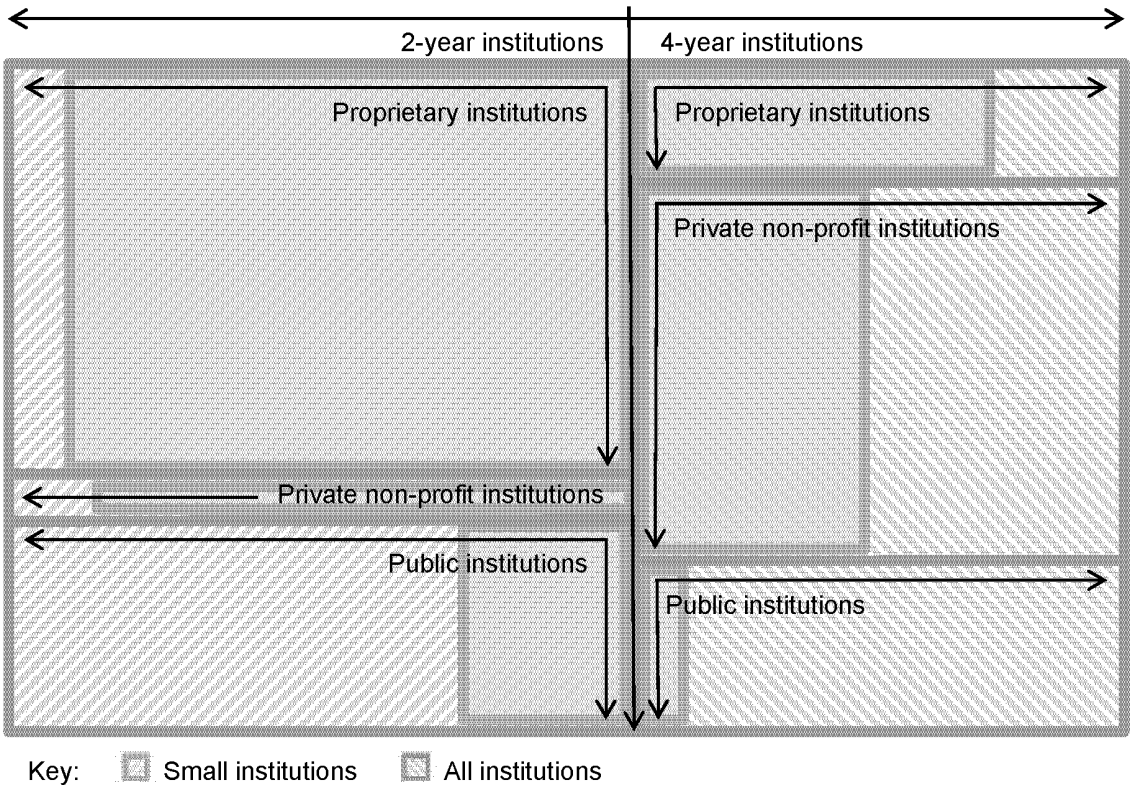
[30] U.S. Department of Education, National Center for Education Statistics. Integrated Postsecondary Education Data System 2016 Institutional Characteristics: Directory Information survey file downloaded March 3, 2018. Available at *nces.ed.gov/ipeds/datacenter/DataFiles.aspx*.

TABLE 8—SMALL INSTITUTIONS UNDER PROPOSED DEFINITION—Continued

Level	Type	Small	Total	Percent
4-year	Proprietary	425	558	76
Total		3,996	6,951	57

Under the proposed definition, the two-year small institutions are 68% of all two-year institutions (2,708/3,962), 68% of all small institutions (2,708/3,996), and 39% of the overall population of institutions (2,708/6,951); whereas, four-year small institutions are 43% of all four-year institutions (1,288/2,989), 32% of all small institutions (1,288/3,996), and 19% of the overall population of institutions (1,288/6,951). Figure 1 shows a visual representation of the universe and the percentage that would be defined as small using the above proposed definition.

Figure 1: Small Institutions as a subset of all institutions



Similarly, small public institutions are 20 percent of all public institutions (406/1,999), 10 percent of all small public institutions (406/3,996), and 6 percent of the overall population of institutions (406/6,951). Small private nonprofit institutions are 53 percent of all private nonprofit institutions (1,018/1,999), 25 percent of all small institutions (1,018/3,996), and 15 percent of the overall population of institutions (1,018/6,951). Finally, small proprietary institutions are 85 percent of all proprietary institutions (2,572/1,999), 64 percent of all small institutions (2,572/3,996), and 37 percent of the overall population of institutions (2,572/6,951).

The Department requests comments on the proposed definition. It will consider these suggestions in development of the final rule.

2. Certification

When an agency issues a rulemaking proposal, the Regulatory Flexibility Act (RFA) requires the agency to ''prepare and make available for public comment an initial regulatory flexibility analysis'' which will ''describe the impact of the proposed rule on small entities.'' (5 U.S.C. 603(a)). Section 605 of the RFA allows an agency to certify a rule, in lieu of preparing an analysis, if the proposed rulemaking is not expected to have a significant economic impact on a substantial number of small entities.

This proposed rule directly affects all public nonprofit and proprietary institutions and a small proportion of all institutions participating in title IV programs. There are currently 5868 of these institutions, of which 1799 are public nonprofit and 1896 are proprietary. Using its proposed definition for small institution, below, the Department estimates that approximately 51 percent of these institutions are small entities. Further, 69 percent of the private nonprofit and proprietary institutions are small entities. Therefore, the Department has determined that this proposed rule would have an impact on a substantial number of small entities.

However, the Department has determined that the impact on entities affected by the proposed regulations would not be significant. The effect of the proposed regulations would be to update financial statements submitted to the Department to comply with the new FASB standards and to reduce liabilities at some institutions associated with borrower defense claims. The Department expects the impact of the proposed financial responsibility regulations would be a *de minimis* increase in paperwork burden for private nonprofit and proprietary institutions. The Department asserts that the economic impact of the paperwork burden would be minimal to small institutions. The Department expects the impact of the proposed borrower defense to repayment regulations would be a benefit of reduced liability for a small number of small entities, which represent less than 8 percent of title IV-participating institutions. The Department asserts that the economic impact of the reduced liability, if any, would be minimal and entirely beneficial to small institutions. Accordingly, the Secretary hereby certifies that these proposed regulations, if promulgated, would not have a significant economic impact on a substantial number of small entities. The Department invites comment from members of the public who believe there will be a significant impact on institutions.

Paperwork Reduction Act of 1995

As part of its continuing effort to reduce paperwork and respondent burden, the Department provides the general public and Federal agencies with an opportunity to comment on proposed and continuing collections of information in accordance with the Paperwork Reduction Act of 1995 (PRA) (44 U.S.C. 3506(c)(2)(A)). This helps ensure that: The public understands the Department's collection instructions, respondents can provide the requested data in the desired format, reporting burden (time and financial resources) is minimized, collection instruments are clearly understood, and the Department can properly assess the impact of collection requirements on respondents.

Sections 668.41, 668.171, and 668.172, appendix A & B to part 668, subpart L, and §§ 674.33, 682.402, 685.206, 685.214 685.215, and 685.304 of this proposed rule contain information collection requirements. Under the PRA, the Department has or will at the required time submit a copy of these sections and an Information Collections Request to OMB for its review.

A Federal agency may not conduct or sponsor a collection of information unless OMB approves the collection under the PRA and the corresponding information collection instrument displays a currently valid OMB control number. Notwithstanding any other provision of law, no person is required to comply with, or is subject to penalty for failure to comply with, a collection of information if the collection instrument does not display a currently valid OMB control number.

In the final regulations, we will display the control numbers assigned by OMB to any information collection requirements proposed in this NPRM and adopted in the final regulations.

Section 668.41 Reporting and disclosure of information.

Requirements: Under the proposed changes in § 668.41(h), an institution that uses pre-dispute arbitration agreements and/or class action waivers would be required to disclose that information in a plain language disclosure available to enrolled and prospective students, and the public on its website where admissions and tuition and fees information is made available.

Burden Calculation: There will be burden on schools to make additional disclosures of the institution's use of a pre-dispute arbitration agreement and/or class action waiver to students, prospective students, and the public under this proposed regulation. Such agreements are currently used primarily by proprietary institutions. Of the 1,888 proprietary institutions participating in the title IV, HEA programs, we estimate that 50 percent or 944 would use a pre-dispute arbitration agreement and/or class action waiver and would provide the required information electronically. We anticipate that it will take an average of 5 hours to develop, program, and post the required information to the websites where admission and tuition and fees information is made available. The estimated burden would be 4,720 hours (944 x 5 hours) under OMB Control Number 1845–0004.

Section 668.171 General.

Requirements: Under the proposed § 668.171(f), in accordance with procedures to be established by the Secretary, an institution would notify the Secretary of any action or event described in the specified number of days after the action or event occurred. In the notice to the Secretary or in the institution's preliminary response, the institution may show that certain of the actions or events are not material or that the actions or events are resolved.

Burden Calculation: There will be burden on institutions to provide the notice to the Secretary when one of the actions or events occurs. We estimate that an institution will take two hours per action to prepare the appropriate notice and to provide it to the Secretary. We estimate that 180 private institutions may have two events annually to report for a total burden of 720 hours (180 institutions × 2 events × 2 hours). We estimate that 379 proprietary institutions may have three events annually to report for a total burden of 2,274 hours (379 institutions × 3 events × 2 hours). This total burden of 2,994 hours will be assessed under OMB Control Number 1845–0022.

Section 668.172 Financial Ratios.

Requirements: Under § 668.172(d), institutions can ask the Secretary to compute a second composite score excluding operating leases and have the higher of the two composite scores used to determine, in part, if the institution meets the financial responsibility requirements to participate in title IV financial aid programs.

Burden Calculation: There will be burden on institutions to request that the Secretary perform the second composite scoring calculation. We estimate that it will take a school .25 hours (15 minutes) to request the recalculation. We further estimate that 25% of the private institutions 450 (1,799 × .25) will request the recalculation for 113 hours (450 institutions × .25 hours). We estimate that 25% of the proprietary institutions 474 (1,896 × .25) will request the recalculation for 119 hours (474 institutions × .25 hours). This total burden of 232 hours (113 + 119) will be assessed under the OMB Control Number 1845–0022.

Appendix A and B for Section 668—Subpart L—Financial Responsibility

Requirements: Under proposed Section 2 for appendix A and B, proprietary and private schools would be required to submit a Supplemental Schedule as part of their audited financial statements. With the update from the FASB, some elements needed to calculate the composite score would no longer be readily available in the audited financial statements, particularly for private institutions. With the proposed updates to the Supplemental Schedule to reference the financial statements, this issue would be addressed in a convenient and transparent manner for both the schools and the Department by showing how the composite score is calculated.

Burden Calculation: There will be burden on schools to provide the Supplemental Schedule to the Department. In development of this

proposal, the members of the negotiated rulemaking subcommittee indicated that they believed that as the information would be readily available upon completion of the required audit the burden would be minimal. We estimate that it will take each proprietary and private institution one hour to prepare the Supplemental Schedule and have it made available for posting along with the annual audit. We estimate that 1,799 private schools will require 1 hour of burden to prepare the Supplemental Schedule and have it made available for posting along with the annual audit for a total burden of 1,799 hours (1,799 institutions × 1 hour). We estimate that 1,896 proprietary schools will require 1 hour of burden to prepare the Supplemental Schedule and have it made available for posting along with the annual audit for a total burden of 1,896 hours (1,896 institutions × 1 hour). This total burden of 3,695 hours will be assessed under OMB Control Number 1845–0022.

The total additional burden under OMB Control Number 1845–0022 would be 6,921 hours.

Section 674.33 Repayment.

Section 682.402 Death, disability, closed school, false certification, unpaid refunds, and bankruptcy payments.

Section 685.214 Closed school discharge.

Requirements: Under the proposed language in §§ 674.33(g), 682.402(d), and 685.214(c), the number of days that a borrower must have withdrawn from a closed school to qualify for a closed school discharge would be extended from 120 days to 180 days. Additionally if a closed school provided a borrower an opportunity to complete his or her academic program through a teach-out plan approved by the school's accrediting agency and, if applicable, the school's State authorizing agency, the borrower would not qualify for a closed school discharge. The proposed regulations further provide that the Secretary may extend that proposed 180 days further if there is a determination that exceptional circumstances justify an extension.

Burden Calculation: The proposed extension from 120 days to 180 days for withdrawal prior to the closing of the school would require an update to the current closed school discharge application form with OMB Control Number 1845–0058. We do not believe that the language update will change the amount of time currently assessed for the borrower to complete the form from those which has already been approved. The form update would be completed and made available for comment through a full public clearance package before being made available for use by the effective date of the regulations is finalized.

Section 682.402 Death, disability, closed school, false certification, unpaid refunds, and bankruptcy payments.

Requirements: Under proposed regulations in § 682.402 a second level of Departmental review for denied closed school discharge claim in the FFEL Program would be provided. The proposed regulations would require a guaranty agency that denies a closed school discharge application to inform the borrower of the opportunity for a review of the guaranty agency's decision by the Secretary, and an explanation of how the borrower may request such a review.

Burden Calculation: We believe there would be burden on the guaranty agencies to update their systems to identify borrowers who were enrolled or withdrew no more than 120 days to 180 days before an institution's closure for reporting to lenders. We estimate that it will take the 13 public guaranty agencies 10 hours for programming and testing to update their systems with this change for 130 hour burden increase (13 guaranty agencies × 10 hours = 130). We estimate that it will take the 11 non-profit guaranty agencies 10 hours for programming and testing to update their systems with this change for 110 hour burden increase (11 guaranty agencies × 10 hours = 110). There would be a total increase in burden of 240 hours under OMB Control Number 1845–0020.

There would also be burden on guaranty agencies to provide information to borrowers denied closed school discharges regarding the opportunity for further review of the discharge request by the Secretary. We estimate that it will take the 13 public guaranty agencies 4 hours totaling 52 hours (13 guaranty agencies × 4 hours = 52) to update their notifications and establish a process for forwarding any requests for escalated reviews to the Secretary. We further estimate that it will take the 11 non-profit guaranty agencies 4 hours totaling 44 hours (11 guaranty agencies × 4 hours = 44) to update their notifications and establish a process for forwarding any requests for escalated reviews to the Secretary. There would be a total increase in burden of 96 hours under OMB Control Number 1845–0020.

There would be burden on guaranty agencies, upon receipt of the request for escalated review from the borrower, to forward to the Secretary the discharge form and any relevant documents. For calendar year 2017 29,171 closed school discharge applications were received. It is estimated that 5 percent, or 1,459, of those borrowers would have their applications denied. We further estimate that 10 percent, or 146, of those borrowers whose applications were denied will request a review by the Secretary. We estimate that the process to forward the discharge to the Secretary will take 30 minutes per request. There would be an estimated burden of 40 hours for the 13 public guaranty agencies based on an estimated 79 requests (79 × .5 hours = 40 hours). There would be an estimated burden of 34 hours for the 11 non-profit guaranty agencies based on an estimated 67 requests (67 × .5 = 34 hours). There will be an increase in burden of 74 hours under OMB Control Number 1845–0020.

There will be a total increase in burden of 410 hours based on the proposed changes to section 682.402 under OMB Control Number 1845–0020.

Section 685.206 Borrower responsibilities and defenses.

Requirements: Under proposed § 685.206(d), a defense to repayment discharge claim on a Direct Loan disbursed after July 1, 2019 would be evaluated under the proposed Federal standard. Under proposed § 685.206(d), a defense to repayment must be submitted within three years from the date the student is no longer enrolled at the institution.

Burden Calculation: We believe that the burden will be associated with the new form that the borrower receives that accompanies the notice of action from the Department. The new form would be completed and made available for comment through a full public clearance package before being made available for use.

Section 685.215 Discharge for false certification of student eligibility or unauthorized payment.

Requirements: Under proposed § 685.215, the application requirements for false certification discharges would be amended to reflect the current practice of requiring a borrower to apply for the discharge using a Federal application form instead of a sworn statement. The proposed regulations also would remove the term ''ability to benefit'' to reflect changes to the HEA. Under the proposed regulatory changes, a Direct Loan borrower would not qualify for a false certification discharge based on not having a high school diploma in cases when the borrower did not obtain an official transcript or diploma from the high school, and the borrower provided an attestation to the institution that the borrower was a high school graduate.

Burden Calculation: The proposed clarification to require the submission of a Federal application to receive a

discharge and updating of the form to remove ''ability to benefit'' language will require an update to the current false certification application form with OMB Control Number 1845–0058. We do not believe that the language update will change the amount of time currently assessed for the borrower to complete the form, nor an increase in the number of borrowers who may qualify, to complete the form from those that have already been approved. The form update would be completed and made available for comment through a full public clearance package before being made available for use by the effective date of the regulations.

Section 685.304 Counseling Borrowers.

Requirements: Under proposed § 685.304 there are changes to the requirements to counsel Federal student loan borrowers prior to making the first disbursement of a Federal student loan (entrance counseling). Schools that use pre-dispute arbitration agreements and/or class action waivers will have to include in the required entrance counseling information on the school's internal dispute resolution process and who the borrower may contact regarding a dispute related to educational services for which the loan was made. Schools that require borrowers to accept a pre-dispute arbitration agreement and/or class action waiver would be required to provide information in writing to the student borrower about the plain language meaning of the agreement, when it would apply, how to enter into the process, and who to contact with questions.

Burden Calculation: We believe there will be burden on the schools to create any school specific pre-dispute arbitration agreement and/or class action waivers and provide that information in addition to complying with the current entrance counseling requirements. Of the 1,888 participating proprietary institutions, we estimate that 50 percent or 944 institutions would need to create additional entrance counseling information regarding the use of the pre-dispute arbitration agreement and/or class action waivers to provide to their student borrowers. We anticipate that it would take an average of 3 hours to adapt the information provided in proposed § 668.41 as a part of the required entrance counseling, to identify staff who would be able to answer additional questions, and to obtain evidence indicating the provision of the material for a total of 2,832 hours (944 × 3 hours).

Additionally, we believe that there will be minimum additional burden for borrowers to review the information when completing the required entrance counseling and provide the required evidence that the borrowers received the information. In calendar year 2017, 684,813 Direct Loan borrower completed entrance counseling using the Department's on-line entrance counseling. Assuming the same 50 percent of borrowers attend a school that uses pre-dispute arbitration agreements and/or class action waivers would require five minutes to review the material and provide evidence of receipt of the information, we estimate a total of 27,393 hours of additional burden (342,407 borrowers time .08 (5 minutes) = 27,393 hours). There would be a total increase in burden of 30,225 hours under OMB Control Number 1845–0021.

Consistent with the discussions above, the following chart describes the sections of the proposed regulations involving information collections, the information being collected and the collections that the Department will submit to OMB for approval and public comment under the PRA, and the estimated costs associated with the information collections. The monetized net cost of the increased burden for institutions, lenders, guaranty agencies and students, using wage data developed using Bureau of Labor Statistics data, available at *https://www.bls.gov/ooh/management/postsecondary-education-administrators.htm* is $1,107,460 as shown in the chart below. This cost is based on an estimated hourly rate of $44.41 for institutions, lenders, and guaranty agencies and $16.30 for students.

COLLECTION OF INFORMATION

Regulatory section	Information collection	OMB control No. and estimated burden (change in burden)	Estimated costs
§ 668.41	Under the proposed regulatory language in 668.41(h) institutions that use pre-dispute arbitration agreements and/or class action waivers would be required to disclose that information in a plain language disclosure available to enrolled and prospective students, and the public on its website where admissions and tuition and fees information is made available.	1845–0004; + 4,720 hours.	$209,615.
§ 668.171	Under the proposed regulatory language in 668.171(f) in accordance with procedures to be established by the Secretary, a school would notify the Secretary of any action or event described in the specified number of days after the action or event occurs. In the notice to the Secretary or in the school's response, the school may show that certain of the actions or events are not material or that the actions or events are resolved.	1845–0022; + 2,994 hours.	132,964.
§ 668.172	Under the proposed regulatory language in 668.172(d) institutions must request a second calculation of the composite score from the Secretary to exclude operating leases.	1845–0022; + 232 hours	10,303.
Appendix A & B of 668 subpart L.	Under proposed Section 2 for appendix A and B, proprietary and private schools would be required to submit a Supplemental Schedule as part of their audited financial statements. With the update from the Financial Standards Accounting Board (FASB) some elements needed to calculate the composite score would no longer be readily available in the audited financial statements, particularly for private institutions. With the proposed updates to the Supplemental Schedule to reference the financial statements, this issue would be addressed in a convenient and transparent manner for both the schools and the Department by showing how the composite score is calculated.	1845–0022; + 3,695 hours.	164,095.

COLLECTION OF INFORMATION—Continued

Regulatory section	Information collection	OMB control No. and estimated burden (change in burden)	Estimated costs
§ 674.33, § 682.402, § 685.2142.	Under the proposed regulations, the number of days that a borrower may have withdrawn from a closed school to qualify for a closed school discharge would extend from 120 days to 180 days, and if a closed school provided a borrower an opportunity to complete their academic program through a teach-out plan approved by the school's accrediting agency and, if applicable, the school's State authorizing agency, the borrower would not qualify for a closed school discharge. The proposed language further allows that the Secretary may extend that proposed 180 days further if there is a determination that exceptional circumstances justify an extension.	1845–0058; + 0 hours	0.
§ 682.402	Under proposed regulations in § 682.402 a second level of Departmental review for denied closed school discharge claim in the FFEL Program would be provided. The proposed regulations would require a guaranty agency that denies a closed school discharge request to inform the borrower of the opportunity for a review of the guaranty agency's decision by the Secretary, and an explanation of how the borrower may request such a review.	1845–0020; + 410	18,208.
§ 685.206	Under proposed § 685.206(d), a borrower defense claim related to a direct loan disbursed after July 1, 2019 would be evaluated under the proposed Federal standard. Under proposed § 685.206(d), a borrower defense must be submitted within three years from the date the borrower is no longer enrolled at the institution.	A new collection will be filed closer to the implementation of this requirement; + 0 hours.	0.
§ 685.215	Under the proposed regulatory language in § 685.215, the application requirements for false certification discharges are amended to reflect the current practice of requiring a borrower to apply for the discharge using a completed application form instead of a sworn statement. The proposed regulatory language proposed removing the use of term ''ability to benefit'' to bring the definition in line with the current HEA language. Under proposed regulatory language, a Direct Loan borrower will not qualify for a false certification discharge based on not having a high school diploma provide that in cases when they did not obtain an official transcript or diploma from the high school, and the borrower provided an attestation to the institution that the borrower was a high school graduate. The attestation would have to be provided under penalty of perjury.	1845–0058; + 0 hours	0.
§ 685.304	Under proposed § 685.304 there are changes to the requirements to counsel Federal student loan borrowers prior to making the first disbursement of a Federal student loan. Schools that use pre-dispute arbitration agreements and/or class action waivers include in the required entrance counseling information on the school's internal dispute resolution process and who the borrower may contact regarding a dispute related to educational services for which the loan was made. Schools that require a pre-dispute arbitration agreement and/or class action waiver would be required to review with the student borrower the agreement and when it would apply, how to enter into the process and who to contact with questions.	1845–0021; + 30,225 hours (2,832 institutions + 27,393 individual hours).	Inst. 125,769; Indiv. 446,506, TOTAL $572,275.

The chart below does not include the burden generated by 2016 final regulations because that regulatory package is not effective.

The total burden hours and change in burden hours associated with each OMB Control number affected by the proposed regulations follows:

Control No.	Total proposed burden hours	Proposed change in burden hours
1845–0004	23,390	+ 4,720
1845–0020	8,248,092	+ 410
1845–0021	739,746	+ 30,225
1845–0022	2,222,891	+ 6,921
Total	11,234,119	+ 42,276

We have prepared Information Collection Requests for these information collection requirements. If you wish to review and comment on the Information Collection Requests, please follow the instructions in the **ADDRESSES** section of this notification.

Note: The Office of Information and Regulatory Affairs in OMB and the Department review all comments posted at *www.regulations.gov.*

In preparing your comments, you may want to review the Information Collection Requests, including the supporting materials, in *www.regulations.gov* by using the Docket ID number specified in this notification. These proposed collections are identified as proposed collections 1845–0004, 1845–0020, 1845–0021, 1845–0022.

We consider your comments on these proposed collections of information in—

- Deciding whether the proposed collections are necessary for the proper performance of our functions, including whether the information will have practical use;
- Evaluating the accuracy of our estimate of the burden of the proposed collections, including the validity of our methodology and assumptions;
- Enhancing the quality, usefulness, and clarity of the information we collect; and
- Minimizing the burden on those who must respond. This includes exploring the use of appropriate automated, electronic, mechanical, or other technological collection techniques.

Between 30 and 60 days after publication of this document in the **Federal Register**, OMB is required to make a decision concerning the collections of information contained in these proposed regulations. Therefore, to ensure that OMB gives your comments full consideration, it is important that OMB receives your comments on these Information Collection Requests by August 30, 2018. This does not affect the deadline for your comments to us on the proposed regulations.

If your comments relate to the Information Collection Requests for these proposed regulations, please specify the Docket ID number and indicate ''Information Collection Comments'' on the top of your comments.

Intergovernmental Review

These programs are not subject to Executive Order 12372 and the regulations in 34 CFR part 79.

Assessment of Educational Impact

In accordance with section 411 of the General Education Provisions Act, 20 U.S.C. 1221e–4, the Secretary particularly requests comments on whether these proposed regulations would require transmission of information that any other agency or authority of the United States gathers or makes available.

Accessible Format: Individuals with disabilities can obtain this document in an accessible format (*e.g.,* Braille, large print, audiotape, or compact disc) on request to one of the persons listed under **FOR FURTHER INFORMATION CONTACT**.

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You may also access documents of the Department published in the **Federal Register** by using the article search feature at: *www.federalregister.gov.* Specifically, through the advanced search feature at this site, you can limit your search to documents published by the Department.

(Catalog of Federal Domestic Assistance Number does not apply.)

List of Subjects

34 CFR Part 668

Administrative practice and procedure, Colleges and universities, Consumer protection, Grant programs—education, Loan programs-education, Reporting and recordkeeping requirements, Selective Service System, Student aid, Vocational education.

34 CFR Part 674

Loan programs—education, Reporting and recordkeeping, Student aid.

34 CFR Parts 682 and 685

Administrative practice and procedure, Colleges and universities, Loan programs—education, Reporting and recordkeeping requirements, Student aid, Vocational education.

Dated: July 19, 2018.

Betsy DeVos,

Secretary of Education.

For the reasons discussed in the preamble, the Secretary of Education proposes to amend parts 668, 674, 682, and 685, of title 34 of the Code of Federal Regulations, as if the delayed amendments from the 2016 final regulations were never published, as follows:

PART 668—STUDENT ASSISTANCE GENERAL PROVISIONS

■ 1. The authority citation for part 668 is revised to read as follows:

Authority: 20 U.S.C. 1001–1003, 1070g, 1085, 1088, 1091, 1092, 1094, 1099c, 1099c–1, 1221–3, and 1231a, unless otherwise noted.

■ 2. Section 668.41 is amended by:

■ a. In paragraph (a), in the definition of ''Undergraduate students'', adding the words ''at or'' before ''below'' and adding the word ''level'' after ''baccalaureate''.

■ b. In paragraph (c)(2) introductory text, removing the phrase ''or (g)'' and adding the phrase ''(g), or (h)'' in its place.

■ c. Adding paragraph (h).

The addition reads as follows:

§ 668.41 Reporting and disclosure of information.

* * * * *

(h) *Enrolled students, prospective students, and the public—disclosure of an institution's use of pre-dispute arbitration agreements and/or class action waivers as a condition of enrollment for students receiving Title IV Federal student aid.*

(1) An institution of higher education that requires students receiving Title IV Federal student aid to accept or agree to a pre-dispute arbitration agreement and/or a class action waiver as a condition of enrollment must make available to enrolled students, prospective students, and the public, a written (electronic) plain language disclosure of those conditions of enrollment on its website where information regarding admissions and tuition and fees is presented. The institution may not rely solely on an intranet website for the purpose of providing this notice to prospective students or the public.

(2) For the purposes of this paragraph (h), the following definitions apply:

(i) *Class action* means a lawsuit or an arbitration proceeding in which one or more parties seeks class treatment pursuant to Federal Rule of Civil Procedure 23 or any State process analogous to Federal Rule of Civil Procedure 23.

(ii) *Class action waiver* means any agreement or part of an agreement, regardless of its form or structure, between a school, or a party acting on behalf of a school, and a student that relates to the making of a Direct Loan or the provision of educational services for which the student received title IV funding and prevents an individual from filing or participating in a class action that pertains to those services.

(iii) *Pre-dispute arbitration agreement* means any agreement or part of an agreement, regardless of its form or structure, between a school, or a party acting on behalf of a school, and a student requiring arbitration of any future dispute between the parties relating to the making of a Direct Loan or provision of educational services for which the student received title IV funding.

* * * * *

■ 3. Section 668.91 is amended by revising paragraphs (a)(3)(i) through (v) to read as follows:

§ 668.91 Initial and final decisions.

(a) * * *

(3) * * *

(i) If, in a termination action against an institution, the hearing official finds that the institution has violated the provisions of § 668.14(b)(18), the hearing official also finds that termination of the institution's participation is warranted;

(ii) If, in a termination action against a third-party servicer, the hearing official finds that the servicer has violated the provisions of § 668.82(d)(1), the hearing official also finds that termination of the institution's participation or servicer's eligibility, as applicable, is warranted;

(iii) In an action brought against an institution or third-party servicer that involves its failure to provide a letter of credit, or other financial protection under § 668.175(h), for a condition or event under § 668.15 or § 668.171(b), (c) or (d), the hearing official finds that the amount of the letter of credit or other financial protection established by the Secretary under § 668.175(c), (d), or (f) is appropriate, unless the institution demonstrates that the amount was not warranted because—

(A) The condition or event no longer exists or has been resolved;

(B) The condition or event does not and will not have a material adverse effect on the financial condition, business, or results of operations of the institution; or

(C) The institution has insurance that will cover the liabilities that arise from that condition or event;

(iv) In a termination action taken against an institution or third-party servicer based on the grounds that the institution or servicer failed to comply with the requirements of § 668.23(c)(3), if the hearing official finds that the institution or servicer failed to meet those requirements, the hearing official finds that the termination is warranted;

(v)(A) In a termination action against an institution based on the grounds that the institution is not financially responsible under § 668.15(c)(1), the hearing official finds that the termination is warranted unless the institution demonstrates that all applicable conditions described in § 668.15(d)(4) have been met; and

(B) In a termination or limitation action against an institution based on the grounds that the institution is not financially responsible—

(*1*) Upon proof of the conditions in § 668.174(a), the hearing official finds that the limitation or termination is warranted unless the institution demonstrates that all the conditions in § 668.175(f) have been met; and

(*2*) Upon proof of the conditions in § 668.174(b)(1), the hearing official finds that the limitation or termination is warranted unless the institution demonstrates that all applicable conditions described in § 668.174(b)(2) have been met; and

* * * * *

■ 4. Section 668.94 is amended by:

■ a. Redesignating paragraphs (h) and (i) as paragraphs (i) and (j), respectively.

■ b. Adding a new paragraph (h).

The addition reads as follows:

§ 668.94 Limitation.

* * * * *

(h) A change in the participation status of the institution from fully certified to participate to provisionally certified to participate under § 668.13(c);

* * * * *

■ 5. Section 668.171 is revised to read as follows:

§ 668.171 General.

(a) *Purpose.* To begin and to continue to participate in any title IV, HEA program, an institution must demonstrate to the Secretary that it is financially responsible under the standards established in this subpart. As provided under section 498(c)(1) of the HEA, the Secretary determines whether an institution is financially responsible based on the institution's ability to—

(1) Provide the services described in its official publications and statements;

(2) Meet all of its financial obligations; and

(3) Provide the administrative resources necessary to comply with title IV, HEA program requirements.

(b) *General standards of financial responsibility.* Except as provided under paragraphs (c), (d), and (h) of this section, the Secretary considers an institution to be financially responsible if the Secretary determines that—

(1) The institution's Equity, Primary Reserve, and Net Income ratios yield a composite score of at least 1.5, as provided under § 668.172 and appendices A and B to this subpart;

(2) The institution has sufficient cash reserves to make required returns of unearned title IV, HEA program funds, as provided under § 668.173;

(3) The institution is able to meet all of its financial obligations and provide the administrative resources necessary to comply with title IV, HEA program requirements. An institution is not be able to meet its financial or administrative obligations if—

(i) It fails to make refunds under its refund policy or return title IV, HEA program funds for which it is responsible under § 668.22;

(ii) It fails to make repayments to the Secretary for debts and liabilities arising from the institution's participation in the title IV, HEA programs; or

(iii) It is subject to an action or event described in paragraph (c) of this section (mandatory triggering events), or an action or event under paragraph (d) of this section (discretionary triggering events) that the Secretary determines is likely to have a material adverse effect on the financial condition of the institution. The Secretary considers a triggering event under these paragraphs only if it occurs on or after July 1, 2019; and

(4) The institution or persons affiliated with the institution are not subject to a condition of past performance under § 668.174(a) or (b).

(c) *Mandatory triggering events.* An institution is not able to meet its financial or administrative obligations under paragraph (b)(3)(iii) of this section if—

(1) After the end of the fiscal year for which the Secretary has most recently calculated an institution's composite score—

(i)(A) The institution incurs a liability arising from defense to repayment discharges adjudicated by the Secretary;

(B) The institution incurs a liability from a final judgment or determination arising from an administrative or judicial action or proceeding; or

(C) For a proprietary institution whose composite score is less than 1.5, there is a withdrawal of owner's equity from the institution by any means, including by declaring a dividend, unless the withdrawal is a transfer to an entity included in the affiliated entity group on whose basis the institution's composite score was calculated; and

(ii) As a result of that liability or withdrawal, the institution's recalculated composite score is less than 1.0, as determined by the Secretary under paragraph (e) of this section.

(2) For a publicly traded institution—

(i) The U.S. Securities and Exchange Commission (SEC) issues an order suspending or revoking the registration of the institution's securities pursuant to Section 12(j) of the Securities and Exchange Act of 1934 (the ''Exchange Act'') or suspends trading of the institution's securities on any national securities exchange pursuant to Section 12(k) of the Exchange Act;

(ii) The national securities exchange on which the institution's securities are traded notifies the institution that it is not in compliance with the exchange's listing requirements and, as a result, the institution's securities are delisted, either voluntarily or involuntarily, pursuant to the rules of the relevant national securities exchange; or

(iii) The U.S. SEC is not in timely receipt of a required report and did not issue an extension to file the report.

(d) *Discretionary triggering events.* The Secretary may determine that an institution is not able to meet its financial or administrative obligations under paragraph (b)(3)(iii) of this section if—

(1) The institution is issued a show-cause order that, if not satisfied, would result in the withdrawal, revocation or suspension of its institutional accreditation, by its institutional accrediting agency for failing to meet one or more of the agency's standards;

(2)(i) The institution violated a provision or requirement in a security or loan agreement with a creditor; and

(ii) As provided under the terms of that security or loan agreement, a monetary or nonmonetary default or delinquency event occurs, or other events occur, that trigger, or enable the creditor to require or impose on the institution, an increase in collateral, a change in contractual obligations, an increase in interest rates or payments, or other sanctions, penalties, or fees;

(3) The institution violated a State licensing or authorizing agency and was notified that its licensure or authorization will be withdrawn or terminated if the institution does not take the steps necessary to come into compliance with those requirements;

(4) For its most recently completed fiscal year, a proprietary institution did not receive at least 10 percent of its

revenue from sources other than title IV, HEA program funds, as provided under § 668.28(c); or

(5) The institution's two most recent official cohort default rates are 30 percent or greater, as determined under subpart N of this part, unless—

(i) The institution files a challenge, request for adjustment, or appeal under that subpart with respect to its rates for one or both of those fiscal years; and

(ii) That challenge, request, or appeal remains pending, results in reducing below 30 percent the official cohort default rate for either or both of those years, or precludes the rates from either or both years from resulting in a loss of eligibility or provisional certification.

(e) *Recalculating the composite score.* The Secretary recalculates an institution's most recent composite score by recognizing the actual amount of the liability incurred by an institution under paragraph (c)(1) of this section as an expense or accounting for the actual withdrawal of owner's equity under paragraph (c)(1)(i)(C) of this section as a reduction in equity. For purposes of this paragraph (e), the Secretary uses the audited financial statements from which the institution's composite score was calculated and the additional information from which the alternative composite score was calculated under § 668.172(d) and accounts for that expense by—

(1) For liabilities incurred by a proprietary institution—

(i) For the primary reserve ratio, increasing expenses and decreasing adjusted equity by that amount;

(ii) For the equity ratio, decreasing modified equity by that amount; and

(iii) For the net income ratio, decreasing income before taxes by that amount;

(2) For liabilities incurred by a non-profit institution—

(i) For the primary reserve ratio, increasing expenses and decreasing expendable net assets by that amount;

(ii) For the equity ratio, decreasing modified net assets by that amount; and

(iii) For the net income ratio, decreasing change in net assets without donor restrictions by that amount; and

(3) For the amount of owner's equity withdrawn from a proprietary institution—

(i) For the primary reserve ratio, decreasing adjusted equity by that amount; and

(ii) For the equity ratio, decreasing modified equity by that amount.

(f) *Reporting requirements.* (1) In accordance with procedures established by the Secretary, an institution must notify the Secretary of the following actions or events—

(i) For a liability incurred from a final judgment or determination under paragraph (c)(1)(ii) of this section, no later than 10 days after the date that the institution is notified of that judgment or determination;

(ii) For a withdrawal of owner's equity described in paragraph (c)(1)(iii) of this section, no later than 10 days after the date that the withdrawal is made;

(iii) For the provisions relating to a publicly traded institution under paragraph (c)(4) of this section, no later than 10 days after the date that:

(A) The SEC issues an order suspending or revoking the registration of the institution's securities pursuant to Section 12(j) of the Exchange Act or suspends trading of the institution's securities on any national securities exchange pursuant to Section 12(k) of the Exchange Act; or

(B) The national securities exchange on which the institution's securities are traded delists, either voluntarily or involuntarily, the institution's securities pursuant to the rules of the relevant national securities exchange;

(iv) For a probation or show cause action under paragraph (d)(1) of this section, 10 days after the institution is notified by its accrediting agency of that action;

(v) For the loan agreement provisions in paragraph (d)(2) of this section, 10 days after a loan violation occurs, the creditor waives the violation, or the creditor imposes sanctions or penalties in exchange or as a result of granting the waiver;

(vi) For a State or agency notice relating to terminating an institution's licensure or authorization under paragraph (d)(3) of this section, 10 days after the institution receives that notice; and

(vii) For the non-title IV revenue provision in paragraph (d)(4) of this section, no later than 45 days after the end of the institution's fiscal year, as provided in § 668.28(c)(3).

(2) The Secretary may take an administrative action under paragraph (h) of this section against an institution if it fails to provide timely notice to the Secretary under this paragraph (f).

(3)(i) In its notice to the Secretary under this paragraph (f), or in its response to a preliminary determination by the Secretary that the institution is not financially responsible because of a triggering event under paragraph (c) or (d) of this section, in accordance with procedures established by the Secretary, the institution may—

(A) Demonstrate that the reported withdrawal of owner's equity under paragraph (c)(1)(iii) of this section was used exclusively to meet tax liabilities of the institution or its owners for income derived from the institution;

(B) Show that the creditor waived a violation of a loan agreement under paragraph (d)(2) of this section. However, if the creditor imposes additional constraints or requirements as a condition of waiving the violation, or imposes penalties or requirements under paragraph (d)(2)(ii) of this section, the institution must identify and describe those penalties, constraints, or requirements and demonstrate that complying with those actions will not adversely affect the institution's ability to meet its financial obligations;

(C) Show that the triggering event has been resolved, or demonstrate that the institution has insurance that will cover all or part of the liabilities that arise from defense to repayment discharges or final judgments or determinations under paragraph (c)(1) of this section; or

(D) Explain or provide information about the conditions or circumstances that precipitated that triggering event that demonstrate that it has not or will not have a material adverse effect on the institution.

(ii) The Secretary will consider the information provided by the institution in determining whether to issue a final determination that the institution is not financially responsible.

(g) *Public institutions.* (1) The Secretary considers a domestic public institution to be financially responsible if the institution—

(i)(A) Notifies the Secretary that it is designated as a public institution by the State, local, or municipal government entity, tribal authority, or other government entity that has the legal authority to make that designation; and

(B) Provides a letter from an official of that State or other government entity confirming that the institution is a public institution; and

(ii) Is not subject to a condition of past performance under § 668.174.

(2) The Secretary considers a foreign public institution to be financially responsible if the institution—

(i)(A) Notifies the Secretary that it is designated as a public institution by the country or other government entity that has the legal authority to make that designation; and

(B) Provides documentation from an official of that country or other government entity confirming that the institution is a public institution and is backed by the full faith and credit of the country or other government entity; and

(ii) Is not subject to a condition of past performance under § 668.174.

(h) *Audit opinions.* Even if an institution satisfies all of the general standards of financial responsibility under paragraph (b) of this section, the Secretary does not consider the institution to be financially responsible if, in the institution's audited financial statements, the opinion expressed by the auditor was an adverse, qualified, or disclaimed opinion, or the auditor expressed doubt about the continued existence of the institution as a going concern, unless the Secretary determines that a qualified or disclaimed opinion does not have a significant bearing on the institution's financial condition.

(i) *Administrative actions.* If the Secretary determines that an institution is not financially responsible under the standards and provisions of this section or under an alternative standard in § 668.175, or the institution does not submit its financial and compliance audits by the date and in the manner required under § 668.23, the Secretary may—

(1) Initiate an action under subpart G of this part to fine the institution, or limit, suspend, or terminate the institution's participation in the title IV, HEA programs; or

(2) For an institution that is provisionally certified, take an action against the institution under the procedures established in § 668.13(d).

■ 6. Section 668.172 is amended by adding paragraph (d) to read as follows:

§ 668.172 Financial ratios.

* * * * *

(d) *Accounting for operating leases.* The Secretary calculates a composite score in accordance with ASU 2016–02, ASC 842 (Leases), but upon request by an institution the Secretary will also compute a second composite score using supplemental information provided by the institution that enables the composite score to be calculated excluding operating leases, and uses the higher of those two composite scores to determine, in part, whether the institution is financially responsible.

* * * * *

■ 7. Section 668.175 is amended by revising paragraphs (a) through (d) and (f) and adding paragraph (h) to read as follows:

§ 668.175 Alternative standards and requirements.

(a) *General.* An institution that is not financially responsible under the general standards and provisions in § 668.171, may begin or continue to participate in the title IV, HEA programs by qualifying under an alternate standard set forth in this section.

(b) *Letter of credit or surety alternative for new institutions.* A new institution that is not financially responsible solely because the Secretary determines that its composite score is less than 1.5, qualifies as a financially responsible institution by submitting an irrevocable letter of credit that is acceptable and payable to the Secretary, or providing other surety described under paragraph (h)(1)(i) of this section, for an amount equal to at least one-half of the amount of title IV, HEA program funds that the Secretary determines the institution will receive during its initial year of participation. A new institution is an institution that seeks to participate for the first time in the title IV, HEA programs.

(c) *Financial protection alternative for participating institutions.* A participating institution that is not financially responsible either because it does not satisfy one or more of the standards of financial responsibility under § 668.171(b), (c) or (d), or because of an audit opinion described under § 668.171(h), qualifies as a financially responsible institution by submitting an irrevocable letter of credit that is acceptable and payable to the Secretary, or providing other financial protection described under paragraph (h) of this section, for an amount determined by the Secretary that is not less than one-half of the title IV, HEA program funds received by the institution during its most recently completed fiscal year, except that this requirement does not apply to a public institution.

(d) *Zone alternative.* (1) A participating institution that is not financially responsible solely because the Secretary determines that its composite score under § 668.172 is less than 1.5 may participate in the title IV, HEA programs as a financially responsible institution for no more than three consecutive years, beginning with the year in which the Secretary determines that the institution qualifies under this alternative.

(i)(A) An institution qualifies initially under this alternative if, based on the institution's audited financial statement for its most recently completed fiscal year, the Secretary determines that its composite score is in the range from 1.0 to 1.4; and

(B) An institution continues to qualify under this alternative if, based on the institution's audited financial statement for each of its subsequent two fiscal years, the Secretary determines that the institution's composite score is in the range from 1.0 to 1.4.

(ii) An institution that qualified under this alternative for three consecutive years, or for one of those years, may not seek to qualify again under this alternative until the year after the institution achieves a composite score of at least 1.5, as determined by the Secretary.

(2) Under the zone alternative, the Secretary—

(i) Requires the institution to make disbursements to eligible students and parents under either the heightened cash monitoring or reimbursement payment method described in § 668.162;

(ii) Requires the institution to provide timely information regarding any of the following oversight and financial events—

(A) Any adverse action, including a probation or similar action, taken against the institution by its accrediting agency;

(B) Any event that causes the institution, or related entity as defined in Accounting Standards Codification (ASC) 850, to realize any liability that was noted as a contingent liability in the institution's or related entity's most recent audited financial statement;

(C) Any violation by the institution of any loan agreement;

(D) Any failure of the institution to make a payment in accordance with its debt obligations that results in a creditor filing suit to recover funds under those obligations; or

(E) Any losses that are unusual in nature or infrequently occur, or both, as defined in accordance with Accounting Standards Update (ASU) No. 2015–01 and ASC 225;

(iii) May require the institution to submit its financial statement and compliance audits earlier than the time specified under § 668.23(a)(4); and

(iv) May require the institution to provide information about its current operations and future plans.

(3) Under the zone alternative, the institution must—

(i) For any oversight or financial event described under paragraph (d)(2)(ii) of this section, in accordance with established procedures, notify the Secretary no later than 10 days after that event occurs; and

(ii) As part of its compliance audit, require its auditor to express an opinion on the institution's compliance with the requirements under the zone alternative, including the institution's administration of the payment method under which the institution received and disbursed title IV, HEA program funds.

(4) If an institution fails to comply with the requirements under paragraph (d)(2) or (3) of this section, the Secretary may determine that the institution no longer qualifies under this alternative.

* * * * *

(f) *Provisional certification alternative.* (1) The Secretary may permit an institution that is not financially responsible to participate in the title IV, HEA programs under a provisional certification for no more than three consecutive years if—

(i) The institution is not financially responsible because it does not satisfy the general standards under § 668.171(b), its recalculated composite score under § 668.171(e) is less than 1.0, it is subject to an action or event under § 668.171(c) or (d) that has an adverse material effect on the institution as determined by the Secretary, or because of an audit opinion described in § 668.171(h); or

(ii) The institution is not financially responsible because of a condition of past performance, as provided under § 668.174(a), and the institution demonstrates to the Secretary that it has satisfied or resolved that condition; and

(2) Under this alternative, the institution must—

(i) Submit to the Secretary an irrevocable letter of credit that is acceptable and payable to the Secretary, or provide other financial protection described under paragraph (h) of this section, for an amount determined by the Secretary that is not less than 10 percent of the title IV, HEA program funds received by the institution during its most recently completed fiscal year, except that this requirement does not apply to a public institution;

(ii) Demonstrate that it was current on its debt payments and has met all of its financial obligations, as required under § 668.171(b)(3), for its two most recent fiscal years; and

(iii) Comply with the provisions under the zone alternative, as provided under paragraphs (d)(2) and (3) of this section.

(3) If at the end of the period for which the Secretary provisionally certified the institution, the institution is still not financially responsible, the Secretary may again permit the institution to participate under a provisional certification but the Secretary—

(i) May require the institution, or one or more persons or entities that exercise substantial control over the institution, as determined under § 668.174(b)(1) and (c), or both, to provide to the Secretary financial guarantees for an amount determined by the Secretary to be sufficient to satisfy any potential liabilities that may arise from the institution's participation in the title IV, HEA programs; and

(ii) May require one or more of the persons or entities that exercise substantial control over the institution, as determined under § 668.174(b)(1) and (c), to be jointly or severally liable for any liabilities that may arise from the institution's participation in the title IV, HEA programs.

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(h) *Financial protection.* In lieu of submitting a letter of credit for the amount required by the Secretary under this section, the Secretary may permit an institution to—

(1) Provide the amount required in the form of other surety or financial protection that the Secretary specifies in a notice published in the **Federal Register**;

(2) Provide cash for the amount required; or

(3) Enter into an arrangement under which the Secretary offsets the amount of title IV, HEA program funds that an institution has earned in a manner that ensures that, no later than the end of a six to twelve-month period selected by the Secretary, the amount offset equals the amount of financial protection the institution is required to provide. The Secretary uses the funds to satisfy the debts and liabilities owed to the Secretary that are not otherwise paid directly by the institution, and provides to the institution any funds not used for this purpose during the period covered by the agreement, or provides the institution any remaining funds if the institution subsequently submits other financial protection for the amount originally required.

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■ 8. Appendix A to subpart L is revised to read as follows:

Appendix A to Subpart L of Part 668—Ratio Methodology for Propriety Institutions

Section 1: Ratio and Ratio Terms

Primary Reserve Ratio $\frac{\textit{Adjusted Equity}}{\text{Total Expenses and Losses}}$

Equity Ratio $\frac{\textit{Modified Equity}}{\text{Modified Assets}}$

Net Income Ratio $\frac{\textit{Income Before Taxes}}{\text{Total Revenue and Gains}}$

Total Expenses and Losses excludes income tax, discontinued operations not classified as an operating expense or change in accounting principle and any losses on investments, post-employment and defined benefit pension plans and annuities. Any losses on investments would be the net loss for the investments. Total Expenses and Losses includes the nonservice component of net periodic pension and other post-employment plan expenses.

Modified Equity = (total owner's equity) − (intangible assets) − (unsecured related-party receivables)

Modified Assets = (total assets) − (intangible assets) − (unsecured related-party receivables)

Income Before Taxes includes all revenues, gains, expenses and losses incurred by the school during the accounting period. Income before taxes does not include income taxes, discontinued operations not classified as an operating expense or changes in accounting principle.

Total Revenues and Gains does not include positive income tax amounts, discontinued operations not classified as an operating gain, or change in accounting principle (investment gains should be recorded net of investment losses.

* Unsecured related party receivables as required at 34 CFR 668.23(d)

** The value of property, plant and equipment includes construction in progress and lease right-of-use assets, and is net of accumulated depreciation/amortization.

*** All debt obtained for long-term purposes, not to exceed total net property, plant and equipment includes lease liabilities for lease right-of-use assets and the short-term portion of the debt, up to the amount of net property, plant and equipment. If an institution wishes to include the debt, including debt obtained through long-term lines of credit in total debt obtained for long-term purposes, the institution must include a disclosure in the financial statements that the debt, including lines of credit exceeds twelve months and was used to fund capitalized assets (*i.e.* property, plant and equipment or capitalized expenditures per Generally Accepted Accounting Principles (GAAP)). The disclosures that must be presented for any debt to be used in adjusted equity include the issue date, term, nature of capitalized amounts and amounts capitalized. Institutions that do not include debt in total debt obtained for long-term purposes, including long-term lines of credit, do not need to provide any additional disclosures other than those required by GAAP. The debt obtained for long-term purposes will be limited to only those amounts disclosed in the financial statements that were used to fund capitalized assets. Any debt amount including long-term lines of credit used to fund operations must be excluded from debt obtained for long-term purposes.

BILLING CODE 4000–01–P

SECTION 2: Financial Responsibility Supplemental Schedule Requirement and Example

A Supplemental Schedule must be submitted as part of the required audited financial statements submission. The Supplemental Schedule contains all of the financial elements required to compute the composite score. Each item in the Supplemental Schedule must have a reference to the Balance Sheet, Statement of (Loss) Income, or Notes to the Financial Statements. The amount entered in the Supplemental Schedules should tie directly to a line item, be part of a line item, tie directly to a note, or be part of a note in the financial statements. When an amount is zero, the institution would identify the source of the amount as NA (Not Applicable) and enter zero as the amount in the Supplemental Schedule. The audit opinion letter must contain a paragraph that references the auditor's additional analysis of the financial responsibility Supplemental Schedule.

"Financial Responsibility Supplemental Schedule"

Example location of number in the financial statements and/or notes - the number reference to sample numbers; however, could be more lines based on financial statements and/or notes.

Line			
		Primary Reserve Ratio: Adjusted Equity	
31	Balance Sheet - Total Equity	Total equity	3,035,000
4, 10	Balance Sheet - Related party receivable, net and Receivable from affiliate, net and Related party note*	Unsecured related party receivables and/or other related party assets	1,130,000
8	Balance Sheet - Property, Plant and Equipment, net*	Property, plant and equipment, net - including construction in progress	7,000,000
9	Balance Sheet - Lease right-of-use asset*	Lease right-of use asset	2,500,000
11	Balance Sheet - Goodwill*	Intangible assets	80,000
27	Balance Sheet - Post-employment and pension liability*	Post-employment and defined pension plan liabilities	300,000
20, 24	Balance Sheet - Notes payable (both current and long-term)*	Long-term debt - for long-term purposes	5,400,000
17, 25	Balance Sheet - Lease right-of-use assets liability (both current and long-term)*	Lease right-of-use asset liability	2,100,000
19, 23	Balance Sheet - Line of Credit-for Long-Term Purposes (both current and long-term) and Line of credit note*	Line of credit - for long-term purposes	575,000
40, 42, 44, 45	Statement of (Loss) Income - Total Operating Expenses, Interest Expense, Loss on Impairment of Assets and Loss on Disposal of Assets*	**Total Expenses and Losses:**	5,900,000
		Equity Ratio: Modified Equity	
31	Balance Sheet - Total Equity	Total equity	3,035,000
11	Balance Sheet - Goodwill*	Intangible assets	80,000
4, 10	Balance Sheet - Related party receivable, net and Receivable from affiliate, net and Related party note*	Unsecured related party receivables and/or other related party assets	1,130,000
		Modified Assets:	

13	Balance Sheet - Total Assets	Total assets	14,210,000
11	Balance Sheet - Goodwill*	Intangible assets	80,000
4,10	Balance Sheet - Related party receivable, net and Receivable from affiliate, net and Related party note*	Unsecured related party receivables and/or other related party assets	1,130,000
		Net Income Ratio:	
48	Statement of (Loss) Income - Net Income Before Income Taxes	**Income Before Taxes**	1,070,000
35, 43, 46	Statement of (Loss) Income - Total Revenue, Interest income and Other miscellaneous income*	**Total Revenues and Gains**	6,970,000
Lease right-of-use assets, net in place as of 7/1/2019 included in Financial Statements as a result of ASU 2016-2			1,500,000
Related Lease right-of-use assets liability for the above lease right-of use-assets as a result of ASU 2016-2			1,250,000

* In the example the number came from the actual financial statements; however, the number could come from the notes.

SECTION 3: Example Financial Statement and Composite Score Calculation

BALANCE SHEET

Line		
	Current Assets	
1	Cash and cash equivalents	790,000
2	Accounts receivable, net	1,010,000
3	Prepaid expenses	150,000
4	Related party receivable	130,000
5	Related party receivable, secured	200,000
6	Student loans receivable, net	1,330,000
7	**Total Current Assets**	3,610,000
8	Property, plant and equipment, net	7,000,000
9	Lease right-of-use assets, net	2,500,000
10	Receivable from affiliate, net	1,000,000
11	Goodwill	80,000
12	Deposits	20,000
13	**Total Assets**	14,210,000
	Current Liabilities	
14	Accounts payable	350,000
15	Accrued expenses	500,000
16	Deferred revenue	650,000
17	Leases right-of-use assets liability	100,000
18	Line of credit – operating	100,000
19	Line of credit - for long term purposes	75,000
20	Note payable	400,000
21	**Total Current Liabilities**	2,175,000
22	Line of credit – operating	200,000
23	Line of credit - for long term purposes	500,000
24	Notes payable	5,000,000
25	Lease right-of-use asset liabilities	2,000,000
26	Other liabilities	1,000,000
27	Post-employment and pension liability	300,000
28	**Total Liabilities**	11,175,000
	Equity	
29	Common stock	500,000
30	Retained earnings	2,535,000
31	**Total Equity**	3,035,000
32	**Total Liabilities and Equity**	14,210,000

STATEMENT OF (LOSS) INCOME

Line		
	Revenue	
33	Tuition and fees, net	6,400,000
34	Clinic revenue	300,000
35	**Total Revenue**	6,700,000
	Operating Expenses	
36	Education expense	2,000,000
37	General expense	1,400,000
38	Occupancy expense	500,000
39	Depreciation and Amortization	350,000
40	**Total Operating Expenses**	4,250,000
41	**Operating Income (Loss)**	2,450,000
	Other Income (expense)	
42	Interest expense	(750,000)
43	Interest income	20,000
44	Loss on impairment of assets	(400,000)
45	Loss on disposal of assets	(500,000)
46	Other miscellaneous income	250,000
47	**Total Other Income (Expense)**	(1,380,000)
48	**Net Income Before Income Taxes**	1,070,000
49	Income taxes	267,000
50	**Net Income (Loss)**	803,000

Calculating the Composite Score	Lines		
Primary Reserve Ratio = Adjusted Equity	31-11-(4+10)-(8+9)+27+(17+19+20+23+24+25)	700,000	**0.1186**
/ Total Expenses and Losses	40 +42 +44 +45	5,900,000	
Equity Ratio = Modified Equity	31 -(4 +10) -11	1,825,000	**0.1404**
/ Modified assets	13 -(4 +10) -11	13,000,000	
Net Income Ratio = Income Before Taxes	48	1,070,000	**0.1535**
/Total Revenues and Gains	35 +43 +46	6,970,000	

Step 1: Calculate the strength factor score for each ratio by using the following algorithms:

Primary Reserve strength factor score = 20 x the primary reserve ratio result

Equity strength factor score = 6 x the equity ratio result

Net Income strength factor score = 1 + (33.3 x net income ratio result)

If the strength factor score for any ratio is greater than or equal to 3, the strength factor score for that ratio is 3.

If the strength factor score for any ratio is less than or equal to -1, the strength factor score for that ratio is -1

Step 2: Calculate the weighted score for each ratio and calculate the composite score by adding the three weighted scores

Primary Reserve weighted score = 30% x the primary reserve strength factor score

Equity weighted score = 40% x the equity strength factor score

Net Income weighted score = 30% x the net income strength factor score

Composite Score = the sum of all weighted scores

Round the composite score to one digit after the decimal point to determine the final score

RATIO	Ratio	Strength Factor	Weight	Composite Scores
Primary Reserve Ratio	0.1186	2.3729	30%	0.7119
Equity Ratio	0.1404	0.8423	40%	0.3369
Net Income Ratio	0.1535	3.0000	30%	0.9000
				1.9488
TOTAL Composite Score - Rounded				**1.9**

BILLING CODE 4000–01–C

■ 9. Appendix B to subpart L is revised to read as follows:

Appendix B Subpart L of Part 668—Ratio Methodology for Private Non-Profit Institutions

Section 1: Ratio and Ratio Terms

Primary Reserve Ratio $\frac{\textit{Expendable Net Assets}}{\text{Total Expenses without Donor Restrictions and Losses without Donor Restrictions}}$

Equity Ratio $\frac{\textit{Modified Net Assets}}{\text{Modified Assets}}$

Net Income Ratio $\frac{\textit{Change in Net Assets without Donor Restrictions}}{\text{Total Revenue without Donor Restrictions and Gains without Donor Restrictions}}$

Definitions

Expendable Net Assets = (net assets without donor restrictions) + (net assets with donor restrictions) − (net assets with donor restrictions: restricted in perpetuity) * − (annuities, term endowments and life income funds with donor restrictions) ** − (intangible assets) − (net property, plant and equipment) *** + (post-employment and defined benefit pension plan liabilities) + (all long-term debt obtained for long-term purposes, not to exceed total net property, plant and equipment) **** − (unsecured related party transactions) *****

Total Expenses without Donor Restrictions and Losses without Donor Restrictions = All expenses and losses without donor restrictions from the Statement of Activities less any losses without donor restrictions on investments, post-employment and defined benefit pension plans and annuities. (For institutions that have defined benefit pension and other post-employment plans, total expenses include the nonservice component of net periodic pension and other post-employment plan expenses, and these expenses will be classified as non-operating. Consequently such expenses will be labeled non-operating or included with ''other changes—nonoperating changes—in net assets without donor restrictions'' when the Statement of Activities includes an operating measure).

Modified Net Assets = (net assets without donor restrictions) + (net assets with donor restrictions) − (intangible assets) − (unsecured related party receivables)

Modified Assets = (total assets) − (intangible assets) − (unsecured related party receivables)

Change in net assets without donor restrictions is taken directly from the audited financial statements.

Total Revenue without Donor Restriction and Gains without Donor Restrictions = total revenue (including amounts released from restriction) plus total gains. With regard to gains, investment returns are reported as a net amount (interest, dividends, unrealized and realized gains and losses net of external and direct internal investment expense). Institutions that separately report investment spending as operating revenue (*e.g.,* spending from funds functioning as endowment) and remaining net investment return as a non-operating item, will need to aggregate these two amounts to determine if there is a net investment gain or a net investment loss (net investment gains are included with total gains).

* Net assets with donor restrictions: Restricted in perpetuity is subtracted from total net assets. The amount of net assets with donor restrictions: Restricted in perpetuity is disclosed as a line item, part of line item, in a note, or part of a note in the financial statements.

** Annuities, term endowments and life income funds with donor restrictions is subtracted from total net assets. The amount of annuities, term endowments and life income funds with donor restrictions is disclosed in as a line item, part of line item, in a note, or part of a note in the financial statements.

*** The value of property, plant and equipment includes construction in progress and lease right-of-use assets, and is net of accumulated depreciation/amortization.

**** All Debt obtained for long-term purposes, not to exceed total net property, plant and equipment includes lease liabilities for lease right-of-use assets and the short-term portion of the debt, up to the amount of net property, plant and equipment. All Debt obtained for long-term purposes, not to exceed total net property, plant and equipment includes lease liabilities for lease right-of-use assets and the short-term portion of the debt, up to the amount of net property, plant and equipment. If an institution wishes to include the debt, including debt obtained through long-term lines of credit in total debt obtained for long-term purposes, the institution must include a disclosure in the financial statements that the debt, including lines of credit exceeds twelve months and was used to fund capitalized assets (*i.e.,* property, plant and equipment or capitalized expenditures per Generally Accepted Accounting Principles (GAAP)). The disclosures that must be presented for any debt to be included in expendable net assets include the issue date, term, nature of capitalized amounts and amounts capitalized. Institutions that do not include debt in total debt obtained for long-term purposes, including long-term lines of credit, do not need to provide any additional disclosures other than those required by GAAP. The debt obtained for long-term purposes will be limited to only those amounts disclosed in the financial statements that were used to fund capitalized assets. Any debt amount including long-term lines of credit used to fund operations must be excluded from debt obtained for long-term purposes.

***** Unsecured related party receivables as required at 34 CFR 668.23(d).

BILLING CODE 4000–01–P

SECTION 2: Financial Responsibility Supplemental Schedule Requirement and Example

A Supplemental Schedule must be submitted as part of the required audited financial statements submission. The Supplemental Schedule contains all of the financial elements required to compute the composite score. Each item in the Supplemental Schedule must have a reference to the Statement of Financial Position, Statement of Activities, Schedule of Natural to Functional Expenses, or Notes to the Financial Statements. The amount entered in the Supplemental Schedule should tie directly to a line item, be part of a line item, tie directly to a note, or be part of a note in the financial statements. When an amount is zero, the institution would identify the source of the amount as NA (Not Applicable) and enter zero as the amount in the Supplemental Schedule. The audit opinion letter must contain a paragraph that references the auditor's additional analysis of the financial responsibility Supplemental Schedule.

"Financial Responsibility Supplemental Schedule"

Example location of number in the financial statements and/or notes - the number reference to sample numbers; however, could be more lines based on financial statements and/or notes

		Primary Reserve Ratio:	
		Expendable Net Assets:	
31	Statement of Financial Position - Total Net Assets	Total net assets	26,990,000
4	Statement of Financial Position - Related party receivable and Related party note disclosure	Unsecured related party receivable	100,000
NA	Statement of Financial Position -Contribution receivable, net and Related party note disclosure**	Related party contribution receivable, net - only with significant relationship	0
8	Statement of Financial Position - Property, plant and equipment, net	Property, plant and equipment, net	40,000,000
9	Statement of Financial Position - Lease right-of-use assets, net	Lease right-of-use asset, net	10,000,000
10	Statement of Financial Position - Goodwill	Intangible assets	500,000
17	Statement of Financial Position - Post-employment and pension liabilities	Post-employment and pension liabilities	6,600,000
20	Statement of Financial Position - Note Payable*	Long-term debt	24,000,000
21	Statement of Financial Position - Lease right-of-use of asset liability	Lease right-of-use asset liability	10,000,000
22	Statement of Financial Position - Line of credit - for long-term purposes*	Line of credit - for long-term purposes	2,000,000
25	Statement of Financial Position - Annuities**	Annuities with donor restrictions	300,000
26	Statement of Financial Position - Term Endowments**	Term endowments with donor restrictions	50,000
27	Statement of Financial Positions—Life Income Funds**	Life income funds with donor restrictions	150,000
29	Statement of Financial Position --Perpetual Funds**	Net assets with donor restrictions: restricted in perpetuity	8,800,000
		Total Expenses and Losses:	

(35), 43, 45, 46, 47, 48, 49	Statement of Activities - (Investment return appropriated for spending), Total Operating Expenses, Investments, net of annual spending gain (loss), Other components of net periodic pension costs, Pension-related changes other than net periodic pension, Change in value of split-interest agreements and Other gains (loss)*	Total expenses without donor restrictions	52,980,000
(35), 45	Statement of Activities - (Investment return appropriated for spending) and Investments, net of annual spending, gain (loss)*	Net investment losses	400,000
48	Statement of Activities - Change in value of split-interest agreements	Change in value of split-interest agreements	80,000
47	Statement of Activities - Pension-related changes other than periodic pension*	Pension -related changes other than net periodic costs	350,000
	-	**Equity Ratio:** **Modified Net Assets:**	
24	Statement of Financial Position - Net Assets without Donor Restrictions	Net assets without donor restrictions	15,190,000
30	Statement of Financial Position - Total Net Assets with Donor Restriction	Net assets with donor restrictions	11,800,000
10	Statement of Financial Position - Goodwill	Intangible assets	500,000
4	Statement of Financial Position - Related party receivable and Related party note disclosure	Unsecured related party receivables	100,000
NA	Statement of Financial Position -Contribution receivable, net and Related party note disclosure**	Related party contribution receivable, net - only with significant relationship	0
		Modified Assets:	
12	Statement of Financial Position - Total assets	Total assets	76,240,000
10	Statement of Financial Position – Goodwill	Intangible assets	500,000
4	Statement of Financial Position - Related party receivables and Related party note disclosure	Unsecured related party receivables	100,000
NA	Statement of Financial Position -Contribution receivable, net and Related party note disclosure**	Related party contribution receivable, net - only with significant relationship	0
		Net Income Ratio:	
51	Statement of Activities - Change in Net Assets Without Donor Restrictions	**Change in Net Assets Without Donor Restrictions**	(80,000)
38, (35), 50	Statement of Activities - (Net assets released from restriction), Total Operating Revenue and Other Additions and Sale of Fixed Assets, gains (losses)	**Total Revenues and Gains**	52,900,000
Lease right-of-use assets, net in place as of 7/1/2019 included in Financial Statements as a result of ASU 2016-02			8,000,000
Related Lease right-of-use liability for the above Lease right-of use assets as a result of ASU 2016-02			8,000,000

* In the example the number came from the actual financial statements; however, the number could come from the notes of the financial statements.

SECTION 3: Example Financial Statements and Composite Score Calculation

STATEMENT OF FINANCIAL POSITION

Line		
1	Cash and cash equivalents	1,720,000
2	Accounts receivable, net	6,000,000
3	Prepaid expenses	1,900,000
4	Related party receivable	100,000
5	Contributions receivable, net	2,000,000
6	Student loans receivable, net	8,000,000
7	Investments	6,000,000
8	Property, plant and equipment, net	40,000,000
9	Lease right-of-use asset, net	10,000,000
10	Goodwill	500,000
11	Deposits	20,000
12	**Total Assets**	**76,240,000**
13	Line of credit - short term	300,000
14	Accounts payable	1,000,000
15	Accrued expenses	3,500,000
16	Deferred revenue	650,000
17	Post-employment and pension liability	6,600,000
18	Line of credit - operating	200,000
19	Other liabilities	1,000,000
20	Notes payable	24,000,000
21	Lease right-of-use asset liability	10,000,000
22	Line of credit for long term purposes	2,000,000
23	**Total Liabilities**	**49,250,000**
24	**Net Assets without Donor Restrictions**	**15,190,000**
	Net Assets with Donor Restrictions	
25	Annuities	300,000
26	Term endowments	50,000
27	Life income funds	150,000
28	Other restricted by purpose and time	2,500,000

STATEMENT OF ACTIVITIES

Line		
	Changes in Net Assets Without Donor Restrictions	
	Operating Revenue and Other Additions:	
33	Tuition and fees, net	43,200,000
34	Contributions	1,200,000
35	Investment return appropriated for spending	200,000
36	Auxiliary enterprises	7,000,000
37	Net assets released from restriction	500,000
38	**Total Operating Revenue and Other Additions**	**52,100,000**
	Operating Expenses and Other Deductions:	
39	Education and research expenses	38,000,000
40	Depreciation and Amortization	5,000,000
41	Interest expense	2,880,000
42	Auxiliary enterprises	5,200,000
43	**Total Operating Expenses**	**51,080,000**
44	**Change in Net Assets from Operations**	**1,020,000**
	Non-Operating Changes	
45	Investments, net of annual spending, gain (loss)	(600,000)
46	Other components of net periodic pension costs	(1,000,000)
47	Pension-related changes other than net periodic pension costs	(350,000)
48	Change in value of split-interest agreements	(80,000)
49	Other gains (losses)	(70,000)

29	Restricted in perpetuity	8,800,000
		11,800,00
30	**Total Net Assets with Donor Restrictions**	**0**
		26,990,00
31	**Total Net Assets**	**0**
		76,240,00
32	**Total Liabilities and Net Assets**	**0**

50	Sale of fixed assets, gains (losses)	1,000,000
	Total Non-Operating Changes	**(1,100,000)**
51	**Change in Net Assets Without Donor Restrictions**	**(80,000)**
	Change in Net Assets With Donor Restrictions	
52	Contributions	400,000
53	Net assets released from restriction	(500,000)
54	**Change in Net Assets With Donor Restrictions**	**(100,000)**
55	**Change in Net Assets**	**(180,000)**
56	**Net Assets, Beginning of Year**	**27,170,000**
31	**Net Assets, End of Year**	**26,990,000**

Calculating the Composite Score	Lines		
Primary Reserve Ratio = Adjusted Equity	31-11-(4+10)-(8+9)+27+(17+19+20+23+24+25)	700,000	**0.1186**
/ Total Expenses and Losses	40 +42 +44 +45	5,900,000	
Equity Ratio = Modified Equity	31 -(4 +10) -11	1,825,000	**0.1404**
/ Modified assets	13 -(4 +10) -11	13,000,000	
Net Income Ratio = Income Before Taxes	48	1,070,000	**0.1535**
Total Revenues and Gains	35 +43 +46	6,970,000	

Step 1: Calculate the strength factor score for each ratio by using the following algorithms:

Primary Reserve strength factor score = 10 x the primary reserve ratio result

Equity strength factor score = 6 x the equity ratio result

Negative net income ratio result: Net Income strength factor = 1 + (25 x net income ratio result)

Positive net income ratio result: Net income strength factor = 1 + (50 x net income ratio result)

Zero result for net income ratio: Net income strength factor = 1

If the strength factor score for any ratio is greater than or equal to 3, the strength factor score for the ratio is 3.

If the strength factor score for any ratio is less than or equal to -1, the strength factor score for the ratio is -1.

Step 2: Calculate the weighted score for each ratio and calculate the composite score by adding the three weighted scores

Primary Reserve weighted score = 40% x the primary reserve strength factor score

Equity weighted score = 40% x the equity strength factor score

Net Income weighted score = 20% x the net income strength factor score

Composite Score = the sum of all weighted scores

Round the composite score to one digit after the decimal point to determine the final score

RATIO	Ratio	Strength Factor	Weight	Composite Scores
Primary Reserve Ratio	0.1855	1.8553	40%	0.7421
Equity Ratio	0.3489	2.0933	40%	0.8373
Net Income Ratio	(0.0015)	0.9622	20%	0.1924
				1.7719
TOTAL Composite Score - Rounded				**1.8**

BILLING CODE 4000–01–C

PART 674—FEDERAL PERKINS LOAN PROGRAM

■ 10. The authority citation for part 674 continues to read as follows:

Authority: 20 U.S.C. 1070g, 1087aa–1087hh; Pub. L. 111–256, 124 Stat. 2643; unless otherwise noted.

■ 11. Section 674.33 is amended by:
■ a. Revising paragraph (g)(4).
■ b. In paragraph (g)(8)(i), removing the number ''120'' and adding, in its place, the number ''180''.

The revision reads as follows:

§ 674.33 Repayment.

* * * * *

(g) * * *

(4) *Borrower qualification for discharge.* Except as provided in paragraph (g)(3) of this section, in order to qualify for discharge of an NDSL or Federal Perkins Loan, a borrower must submit to the holder of the loan a completed discharge application on a form approved by the Secretary, and the factual assertions in the application must be true and made by the borrower under penalty of perjury. The application explains the procedures and eligibility criteria for obtaining a discharge and requires the borrower to—

(i) Certify that—

(A) The borrower received the proceeds of a loan to attend a school;

(B) The borrower did not complete the program of study at that school because the school closed while the student was enrolled, or the student withdrew from the school not more than 180 days before the school closed. The Secretary may extend the 180-day period if the Secretary determines that exceptional circumstances related to the school's closing justify an extension. Exceptional circumstances for this purpose may include, but are not limited to: Revocation or withdrawal by an accrediting agency of the school's institutional accreditation; or the State's revocation or withdrawal of the school's license to operate or to award academic credentials in the State;

(C) The borrower did not complete and is not in the process of completing the program of study by transferring academic credit earned at the closed school to another school, or by any other comparable means; and

(D) The school did not provide the borrower an opportunity to complete the program of study in which the borrower was enrolled through a teach-out plan approved by the school's accrediting agency and, if applicable, the school's State authorizing agency.

(ii) [Reserved]

* * * * *

PART 682—FEDERAL FAMILY EDUCATION LOAN (FFEL) PROGRAM

■ 12. The authority citation for part 682 continues to read as follows:

Authority: 20 U.S.C. 1071–1087–4, unless otherwise noted.

§ 682.202 [Amended]

■ 13. Section 682.202 is amended in paragraph (b)(1) by removing the word ''A'' before ''lender'' and adding in in place ''Except as provided in § 682.405(b)(4), a''.
■ 14. Section 682.402 is amended by:
■ a. Revising paragraph (d)(1)(i).
■ b. Revising paragraphs (d)(3) introductory text through (d)(3)(ii)(C).
■ c. Redesignating paragraphs (d)(3)(iii) and (iv) as paragraphs (d)(3)(iv) and (v).
■ d. Adding a new paragraph (d)(3)(iii).
■ e. Revising paragraph (d)(6)(ii)(B).
■ f. Revising the introductory text of paragraph (d)(6)(ii)(F).
■ g. In paragraph (d)(6)(ii)(F)(*3*), removing the number ''120'' and adding, in its place, the number ''180''.
■ h. In paragraph (d)(6)(ii)(F)(*5*), removing the words ''and sworn statement''.
■ i. Revising paragraphs (d)(6)(ii)(G) and (H).
■ j. Adding paragraph (d)(6)(ii)(J).

The revisions and additions read as follows:

§ 682.402 Death, disability, closed school, false certification, unpaid refunds, and bankruptcy payments.

* * * * *

(d) *Closed school*—(1) *General.* (i) The Secretary reimburses the holder of a loan received by a borrower on or after January 1, 1986, and discharges the borrower's obligation with respect to the loan in accordance with the provisions of paragraph (d) of this section, if the borrower (or the student for whom a parent received a PLUS loan) could not complete the program of study for which the loan was intended because the school at which the borrower (or student) was enrolled closed, or the borrower (or student) withdrew from the school not more than 180 days prior to the date the school closed. The Secretary may extend the 180-day period if the Secretary determines that exceptional circumstances related to a school's closing justify an extension. Exceptional circumstances for this purpose may include, but are not limited to: Revocation or withdrawal by an accrediting agency of the school's institutional accreditation, or revocation or withdrawal of the school's license to operate or to award academic credentials in the State.

* * * * *

(3) *Borrower qualification for discharge.* Except as provided in paragraph (d)(8) of this section, in order to qualify for discharge of a loan under paragraph (d) of this section a borrower must submit to the holder of the loan a completed application on a form approved by the Secretary, and the factual assertions in the application must be true and made by the borrower under penalty of perjury. The application explains the procedures and eligibility criteria for obtaining a discharge and requires the borrower to state—

(i) Whether the borrower has made a claim with respect to the school's closing with any third party, such as the holder of a performance bond or a tuition recovery program, and if so, the amount of any payment received by the borrower (or student) or credited to the borrower's loan obligation;

(ii) That the borrower (or the student for whom a parent received a PLUS loan)—

(A) Received, on or after January 1, 1986, the proceeds of any disbursement of a loan disbursed, in whole or in part, on or after January 1, 1986 to attend a school;

(B) Did not complete the educational program at that school because the school closed while the student was enrolled or on an approved leave of absence in accordance with § 668.22(d), or the student withdrew from the school not more than 180 days before the school closed; and

(C) Did not complete the program of study by transferring academic credits or hours earned at the closed school to another school or by any other comparable means;

(iii) The school did not provide the borrower an opportunity to complete the program of study through a teach-out plan approved by the school's accrediting agency and, if applicable, the school's State authorizing agency;

* * * * *

(6) * * *

(ii) * * *

(B) If the guaranty agency determines that a school appears to have closed, it must, within 30 days of making that determination, notify all lenders participating in its program to suspend collection efforts against individuals with respect to loans made for attendance at the closed school, if the student to whom (or on whose behalf) a loan was made, appears to have been enrolled at the school on the closing date, or withdrew not more than 180 days prior to the date the school appears to have closed. Within 30 days after receiving confirmation of the date of a

school's closure from the Secretary, the agency must—

(*1*) Notify all lenders participating in its program to mail a discharge application approved by the Secretary to all borrowers who may be eligible for a closed school discharge; and

(*2*) Review the records of loans that it holds, identify the loans made to any borrower (or student) who appears to have been enrolled at the school on the school closure date or who withdrew not more than 180 days prior to the closure date, and mail a discharge application to the borrower. The application informs the borrower of the procedures and eligibility criteria for obtaining a discharge.

* * * * *

(F) If the guaranty agency determines that a borrower identified in paragraph (d)(6)(ii)(C) or (D) of this section does not qualify for a discharge, the agency must notify the borrower in writing of that determination, the reasons for the decision, and how the borrower may ask the Secretary to review the decision within 30 days after the date the agency—

* * * * *

(G) Upon receipt of a closed school discharge claim filed by a lender, the agency must review the borrower's completed application in light of the information available from the records of the agency and from other sources, including other guaranty agencies, state authorities, and cognizant accrediting associations, and must take the following actions—

(*1*) If the agency determines that the borrower satisfies the requirements for discharge under paragraph (d) of this section, it must pay the claim in accordance with § 682.402(h) not later than 90 days after the agency received the claim; or

(*2*) If the agency determines that the borrower does not qualify for a discharge, the agency must, not later than 90 days after the agency received the claim, return the claim to the lender with an explanation of the reasons for its determination.

(H) If a borrower fails to submit the completed application described in paragraph (d)(3) of this section within 60 days of being notified of that option, the lender or guaranty agency must resume collection and must be deemed to have exercised forbearance of payment of principal and interest from the date it suspended collection activity. The lender or guaranty agency may capitalize, in accordance with § 682.202(b), any interest accrued and not paid during that period.

* * * * *

(J)(*1*) Within 30 days after receiving the borrower's request for review of its decision that the borrower did not qualify for a discharge under paragraph (d)(6)(ii)(F) of this section, the agency must forward the borrower's discharge request and all relevant documentation to the Secretary.

(*2*) After reviewing the documents provided by the agency, the Secretary notifies the agency and the borrower of the decision on the borrower's application for a discharge. If the Secretary determines that the borrower is not eligible for a discharge under paragraph (d) of this section, within 30 days after being informed of the Secretary's decision, the agency must take the actions described in paragraph (d)(6)(ii)(H) of this section, as applicable.

(*3*) If the Secretary determines that the borrower meets the requirements for a discharge under paragraph (d) of this section, the agency must, within 30 days after being informed of the Secretary's decision, take the actions required under paragraphs (d)(6)(ii)(E) and (d)(6)(ii)(G)(*1*) of this section and the lender must take the actions described in paragraph (d)(7)(iv) of this section, as applicable.

* * * * *

■ 15. Section 682.405 is amended by adding paragraph (b)(4)(ii) to read as follows:

§ 682.405 Loan rehabilitation agreement.

* * * * *

(b) * * *

(4) * * *

(ii) The purchase of a rehabilitated loan is not considered a borrower's entry into repayment or resumption of repayment for the purposes of interest capitalization under § 682.202(b).

* * * * *

■ 16. Section 682.410 is amended by revising paragraphs (b)(2) and (4) to read as follows:

§ 682.410 Fiscal, administrative, and enforcement requirements.

* * * * *

(b) * * *

(2) *Collection charges.* (i) Whether or not provided for in the borrower's promissory note and subject to any limitation on the amount of those costs in that note, the guaranty agency may charge a borrower an amount equal to the reasonable costs incurred by the agency in collecting a loan on which the agency has paid a default or bankruptcy claim unless, within the 60-day period following the initial notice described in paragraph (b)(6)(ii) of this section, the borrower enters into an acceptable repayment agreement, including a rehabilitation agreement, and honors that agreement, in which case the guaranty agency must not charge a borrower any collection costs.

(ii) An acceptable repayment agreement may include an agreement described in § 682.200(b) (Satisfactory repayment arrangement), § 682.405, or paragraph (b)(5)(ii)(D) of this section. An acceptable repayment agreement constitutes a repayment arrangement or agreement on repayment terms satisfactory to the guaranty agency, under this section.

(iii) The costs under this paragraph (b)(2) include, but are not limited to, all attorneys' fees, collection agency charges, and court costs. Except as provided in §§ 682.401(b)(18)(i) and 682.405(b)(1)(vi)(B), the amount charged a borrower must equal the lesser of—

(A) The amount the same borrower would be charged for the cost of collection under the formula in 34 CFR 30.60; or

(B) The amount the same borrower would be charged for the cost of collection if the loan was held by the U.S. Department of Education.

* * * * *

(4) *Capitalization of unpaid interest.* The guaranty agency must capitalize any unpaid interest due on the loan at the time the agency pays a default claim to the lender, but must not capitalize any unpaid interest thereafter.

* * * * *

PART 685—WILLIAM D. FORD FEDERAL DIRECT LOAN PROGRAM

■ 17. The authority citation for part 685 continues to read as follows:

Authority: 20 U.S.C. 1070g, 1087a, *et seq.,* unless otherwise noted.

■ 18. Section 685.200 is amended by adding paragraphs (f)(3)(v) and (f)(4)(iii) to read as follows:

§ 685.200 Borrower eligibility.

* * * * *

(f) * * *

(3) * * *

(v) A borrower who receives a closed school, false certification, unpaid refund, or defense to repayment discharge that results in a remaining eligibility period greater than zero is not responsible for the interest that accrues on a Direct Subsidized Loan or on the portion of a Direct Consolidation Loan that repaid a Direct Subsidized Loan unless the borrower once again becomes responsible for the interest that accrues on a previously received Direct Subsidized Loan or on the portion of a Direct Consolidation Loan that repaid a Direct Subsidized Loan, for the life of

the loan, as described in paragraph (f)(3)(i) of this section.

(4) * * *

(iii) For a first-time borrower who receives a closed school, false certification, unpaid refund, or borrower defense discharge on a Direct Subsidized Loan or a portion of a Direct Consolidation Loan that is attributable to a Direct Subsidized Loan, the Subsidized Usage Period is reduced. If the Direct Subsidized Loan or a portion of a Direct Consolidation Loan that is attributable to a Direct Subsidized Loan is discharged in full, the Subsidized Usage Period of those loans is zero years. If the Direct Subsidized Loan or a portion of a Direct Consolidation Loan that is attributable to a Direct Subsidized Loan is discharged in part, the Subsidized Usage Period may be reduced if the discharge results in the inapplicability of paragraph (f)(4)(i) of this section.

* * * * *

■ 19. Section 685.206 is amended by revising paragraph (c) and adding paragraph (d) to read as follows:

§ 685.206 Borrower responsibilities and defenses.

* * * * *

(c)(1) In any proceeding to collect on a Direct Loan first disbursed prior to July 1, 2019, the borrower may assert as a borrower defense to repayment, any act or omission of the school attended by the student that would give rise to a cause of action against the school under applicable State law. These proceedings include, but are not limited to, the following:

(i) Tax refund offset proceedings under 26 U.S.C. 6402(d), 31 U.S.C. 3716 and 3720A.

(ii) Wage garnishment proceedings under section 488A of the Act or under 31 U.S.C. 3720D and 34 CFR part 34.

(iii) Salary offset proceedings for Federal employees under 34 CFR part 31, 5 U.S.C. 5514, and 31 U.S.C. 3716.

(iv) Consumer reporting proceedings under 31 U.S.C. 3711(e).

(2) If a defense to repayment discharge is approved, the Secretary determines the amount of financial relief to be provided and notifies the borrower that the borrower is relieved of the obligation to repay all or part of the loan and associated costs and fees that the borrower would otherwise be obligated to pay. The Secretary affords the borrower such further relief as the Secretary determines is appropriate under the circumstances. Further relief may include, but is not limited to, the following:

(i) Reimbursing the borrower for amounts paid toward the loan voluntarily or through enforced collection.

(ii) Determining that the borrower is not in default on the loan and is eligible to receive assistance under title IV of the Act.

(iii) Updating reports to consumer reporting agencies to which the Secretary previously made adverse credit reports with regard to the borrower's Direct Loan.

(3) The Secretary may initiate an appropriate proceeding to require the school whose act or omission resulted in an approved defense to repayment discharge on a Direct Loan to pay to the Secretary the amount of the loan to which the defense applies. The Secretary will not initiate such a proceeding more than three years after the last award year in which the student attended the school, unless the school received actual notice of the defense to repayment during that period.

(d)(1) For purposes of this paragraph (d):

(i) The term ''borrower'' includes the student who attended the institution or the student on whose behalf a parent borrowed.

(ii) A borrower defense to repayment includes—

(A) A defense to repayment of amounts owed to the Secretary on a Direct Loan; and

(B) Any accompanying request for reimbursement of payments previously made to the Secretary on a Direct Loan.

(iii) The term ''provision of educational services'' refers 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.

(iv) The terms ''school'' and ''institution'' may be used interchangeably and include an eligible institution or school, its officers, directors, employees, representatives, and agents, or any institution or school, organization, or person with whom the eligible school or institution has an agreement to provide educational programs, marketing, advertising, recruiting, or admissions services.

Alternative A for Paragraph (d)(2)(Defensive)

(2) In any proceeding to collect on a Direct Loan first disbursed on or after July 1, 2019, the borrower may assert a claim under this section. These proceedings include the following:

(i) Tax refund offset proceedings under 26 U.S.C. 6402(d), 31 U.S.C. 3716 and 3720A.

(ii) Wage garnishment proceedings under section 488A of the Act or under 31 U.S.C. 3720D and 34 CFR part 34.

(iii) Salary offset proceedings for Federal employees under 34 CFR part 31, 5 U.S.C. 5514, and 31 U.S.C. 3716.

(iv) Consumer reporting agency reporting proceedings under 31 U.S.C. 3711(e).

Alternative B for Paragraph (d)(2) (Defensive and Affirmative)

(2)(i) For loans first disbursed on or after July 1, 2019, a borrower may assert a claim under this section if the borrower establishes by a preponderance of the evidence that—

(A) The institution at which the borrower enrolled acted with an intent to deceive, knowledge of the falsity of a misrepresentation, or a reckless disregard for the truth in making a misrepresentation of material fact, opinion, intention, or law upon which the borrower reasonably relied in deciding to obtain a Direct Loan to enroll or continue enrollment in a program at the institution; and

(B) The borrower was financially harmed by the misrepresentation.

(ii) In any proceeding to collect on a Direct Loan first disbursed on or after July 1, 2019, the borrower may assert a claim under this section. These proceedings include the following:

(A) Tax refund offset proceedings under 26 U.S.C. 6402(d), 31 U.S.C. 3716 and 3720A.

(B) Wage garnishment proceedings under section 488A of the Act or under 31 U.S.C. 3720D and 34 CFR part 34.

(C) Salary offset proceedings for Federal employees under 34 CFR part 31, 5 U.S.C. 5514, and 31 U.S.C. 3716.

(D) Consumer reporting agency reporting proceedings under 31 U.S.C. 3711(e).

(3) To assert a borrower defense to repayment under this paragraph (d), a borrower must submit an application under penalty of perjury on a form approved by the Secretary and sign a waiver permitting the institution to provide the Department with items from the borrower's education record relevant to the defense to repayment claim. The application must—

(i) Certify that the borrower received the proceeds of a loan, in whole or in part, to attend the named school;

(ii) Provide evidence that supports the borrower defense to repayment application;

(iii) State whether the borrower has made a claim with any other third party, such as the holder of a performance bond, a public fund, or a tuition recovery program, based on the same act

or omission of the school on which the borrower defense to repayment is based;

(iv) State the amount of any payment received by the borrower or credited to the borrower's loan obligation through the third party, in connection with a claim described in paragraph (d)(3)(iii) of this section;

(v) State the amount of harm that the borrower alleges to have been caused by the school's action and supply any information relevant to assessing this allegation of harm, including information about whether the borrower failed to actively pursue employment in the field if the borrower is a recent graduate; whether the borrower was terminated or removed for performance reasons from a position in the field for which the borrower's education prepared the borrower, or a related field; and whether the borrower failed to meet other requirements of or qualifications for a job in such field for reasons unrelated to the school's action underlying the borrower defense, such as the borrower's ability to pass a drug test, satisfy criminal history or driving record requirements, and meet any health qualifications; and

(vi) State that the borrower understands that in the event that the borrower receives a 100 percent discharge of the loan for which the defense to repayment application has been submitted, the institution may refuse to verify, or to provide an official transcript that verifies the borrower's completion of credits or a credential associated with the discharged loan.

(4) In the case of a Direct Consolidation Loan first disbursed on or after July 1, 2019, a borrower may assert a borrower defense under the standards in this paragraph (d) with respect to a loan that was repaid by the Direct Consolidation Loan.

Alternative A for Paragraphs (d)(5) Introductory Text and (d)(5)(i) and (ii) (Defensive)

(5) The Secretary will approve the borrower's defense to repayment claim submitted under this paragraph (d) if the borrower in a collections proceeding, in the applicable timeframes for the proceeding, establishes by a preponderance of the evidence that—

(i) The institution at which the student enrolled made a misrepresentation, upon which the borrower reasonably relied under the circumstances in deciding to obtain a Direct Loan, or a loan repaid by a Direct Consolidation Loan, for the student to enroll or continue enrollment in a program at the institution; and

(ii) The borrower suffered financial harm as a result of the misrepresentation by the school.

Alternative B for Paragraphs (d)(5) Introductory Text and (d)(5)(i) and (ii) (Affirmative and Defensive)

(5) The Secretary will approve the borrower's defense to repayment claim submitted under this paragraph (d) if—

(i) In the case of an affirmative claim made by a borrower in repayment under paragraph (d)(2)(ii) of this section—

(A) The borrower submits the claim to the Department within three years from the date the student is no longer enrolled at the institution; and

(B) The Secretary finds that a preponderance of the evidence supports the approval of a borrower defense to repayment; or

(ii) In the case of a defensive claim submitted by a borrower under paragraph (d)(2)(ii) of this section, the borrower in a collections proceeding, in the applicable timeframes for the proceeding, establishes by a preponderance of the evidence that—

(A) The institution at which the student enrolled made a misrepresentation, upon which the borrower reasonably relied under the circumstances in deciding to obtain a Direct Loan, or a loan repaid by a Direct Consolidation Loan, for the student to enroll or continue enrollment in a program at the institution; and

(B) The borrower suffered financial harm as a result of the misrepresentation by the school.

(iii) The Secretary may also consider evidence otherwise in the possession of the Secretary, including from the Department's internal records or other relevant evidence obtained by the Secretary, provided that the Secretary permits the institution to review and respond to this evidence and to submit additional evidence.

(iv) A ''misrepresentation'' is a statement, act, or omission by an eligible school to a borrower that is false, misleading, or deceptive; that was made with knowledge of its false, misleading, or deceptive nature or with a reckless disregard for the truth; and that directly and clearly relates to the making of a Direct Loan, or a loan repaid by a Direct Consolidation Loan, for enrollment at the school or to the provision of educational services for which the loan was made. Evidence that a misrepresentation described in paragraph (d)(5) of this section may have occurred includes:

(A) Actual licensure passage rates materially different from those included in the institution's marketing materials, website, or other communications made to the student;

(B) Actual employment rates materially different from those included in the institution's marketing materials, website, or other communications made to the student;

(C) Actual institutional selectivity rates or rankings, student admission profiles, or institutional rankings that are materially different from those included in the institution's marketing materials, website, or other communications made to the student;

(D) The inclusion in the institution's marketing materials, website, or other communication made to the student of specialized, programmatic, or institutional certifications, accreditation, or approvals not actually obtained, or the failure to remove within a reasonable period of time such certifications or approvals from marketing materials, website, or other communication when revoked or withdrawn;

(E) The inclusion in the institution's marketing materials, website, or other communication made to the student of representations regarding the widespread or general transferability of credits that are only transferrable to limited types of programs or institutions or the transferability of credits to a specific program or institution when no reciprocal agreement exists with another institution or such agreement is materially different than what was represented;

(F) A representation regarding the employability or specific earnings of graduates without an agreement between the institution and another entity for such employment or sufficient evidence of past employment or earnings to justify such a representation or without citing appropriate national data for earnings in the same field as provided by an appropriate Federal agency that provides such data;

(G) A representation regarding the availability, amount, or nature of any financial assistance available to students from the institution or any other entity to pay the costs of attendance at the institution that the school does not fulfill following the enrollment of the borrower;

(H) A representation regarding the amount of tuition and fees that the student would be charged for the program that is materially different in amount, method, or timing of payment from the actual tuition and fees charged to the student;

(I) A representation that the institution, its courses, or programs are endorsed by vocational counselors, high schools, colleges, educational

organizations, employment agencies, members of a particular industry, students, former students, governmental officials, the United States armed forces, or other individuals or entities when the institution has no permission or is not otherwise authorized to use such an endorsement;

(J) A representation regarding the educational resources provided by the institution that are required for the completion of the student's educational program that are materially different from the institution's actual circumstances at the time the representation is made, such as representations regarding the institution's size, location, facilities, training equipment, or the number, availability, or qualifications of its personnel; and

(K) A representation regarding the nature or extent of prerequisites for enrollment in a course or program offered by the institution that are that are materially different from the institution's actual circumstances at the time the representation is made, or that the institution knows will be materially different during the student's anticipated enrollment at the institution.

(v) Financial harm to the borrower has occurred when the borrower suffers monetary loss as a consequence of a misrepresentation described in paragraph (d)(5) of this section and defined in paragraph (d)(5)(iv) of this section. Financial harm does not include damages for nonmonetary loss, such as personal injury, inconvenience, aggravation, emotional distress, pain and suffering, punitive damages, or opportunity costs. The Department does not consider the act of taking out a Direct Loan as evidence of financial harm to the borrower. Financial harm is such monetary loss that is not predominantly due to intervening local, regional, or national economic or labor market conditions as demonstrated by evidence before the Secretary or provided to the Secretary by the borrower or the school. Financial harm cannot 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 includes the following circumstances:

(A) Extended periods of unemployment upon graduating from the school's programs that are unrelated to national or local economic downturns or recessions;

(B) A significant difference between the amount or nature of the tuition and fees that the institution represented to the borrower that the institution would charge or was charging and the actual amount or nature of the tuition and fees charged by the institution for which the Direct Loan was disbursed;

(C) The borrower's inability to secure employment in the field of study for which the institution expressly guaranteed employment; and

(D) The borrower's inability to complete the program because the institution no longer offers a requirement necessary for completion of the program in which the borrower enrolled and the institution did not provide for an acceptable alternative requirement to enable completion of the program.

(6) The Secretary will not accept the following as a basis for a borrower defense to repayment—

(i) A violation by the institution of a requirement of the Act or the Department's regulations for a borrower defense to repayment under paragraph (c) or (d) of this section, unless the violation would otherwise constitute the basis for a successful borrower defense; or

(ii) A claim that is not directly and clearly related to the making of the loan or the provision of educational services by the school including, but not limited to—

(A) Personal injury;

(B) Sexual harassment;

(C) A violation of civil rights;

(D) Slander or defamation;

(E) Property damage;

(F) The general quality of the student's education or the reasonableness of an educator's conduct in providing educational services;

(G) Informal communication from other students;

(H) Academic disputes and disciplinary matters; and

(I) Breach of contract unless the school's act or omission would otherwise constitute the basis for a successful defense to repayment under this section.

(7) Upon receipt of a borrower's request for relief based on defense to repayment, the Department will notify the school of the pending request, provide a copy of the borrower's request and any supporting documents to the school, provide a waiver signed by the student permitting the institution to provide the Department with items from the student's education record relevant to the defense to repayment claim, and invite the school to respond and to submit evidence within the specified timeframe included in the notice. The borrower will receive a copy of the school's response and related evidence.

(8)(i) The Secretary will provide the school the information that will be considered when determining whether to grant the borrower defense to repayment discharge and allow a reasonable opportunity to respond and submit additional evidence. This information may include—

(A) The Department's internal records;

(B) The borrower defense to repayment application and any supporting evidence submitted by the borrower;

(C) The response and any supporting evidence submitted by the school; and

(D) Any other relevant evidence obtained by the Secretary.

(ii) After considering the borrower's application and evidence and any information or evidence provided by the school, the Secretary issues a written decision—

(A) Notifying the borrower and the school of the decision on the borrower defense to repayment;

(B) Providing the reasons for the decision; and

(C) Informing the borrower and the school of the relief, if any, that the borrower will receive, consistent with paragraph (d)(9) of this section.

(9)(i) If the Secretary grants the borrower's request for relief based on defense to repayment, the Secretary notifies the borrower and the school that the borrower is relieved of the obligation to repay all or part of the loan and associated costs and fees that the borrower would otherwise be obligated to pay. In awarding relief, the Secretary shall consider any payments reported by the borrower pursuant to paragraph (d)(3)(iv) of this section.

(ii) The Secretary affords the borrower such further relief as the Secretary determines is appropriate under the circumstances. Further relief includes, if applicable:

(A) Reimbursing the borrower for amounts paid toward the loan voluntarily or through enforced collection;

(B) Determining that the borrower is not in default on the loan and is eligible to receive assistance under title IV of the Act;

(C) Eliminating or recalculating the subsidized usage period that is associated with the loan or loans discharged; and

(D) Updating reports to consumer reporting agencies to which the Secretary previously made adverse credit reports with regard to the borrower's Direct Loan.

(10) The determination of a borrower's defense to repayment by the Department included in the written decision referenced in paragraph (d)(9)

of this section is the final decision of the Department and is not subject to appeal.

(11) The Secretary may revoke any relief granted to a borrower under this section who refuses to cooperate with the Secretary in any proceeding under paragraph (c) or (d) of this section or under subpart G of this part. Such cooperation includes, but is not limited to—

(i) Providing testimony regarding any representation made by the borrower to support a successful borrower defense to repayment; and

(ii) Producing, within timeframes established by the Secretary, any documentation reasonably available to the borrower with respect to those representations and any sworn statement required by the Secretary with respect to those representations and documents.

(12)(i) Upon the grant of any relief under paragraph (c) or (d) of this section, the borrower is deemed to have assigned to, and relinquished in favor of, the Secretary any right to a loan refund (up to the amount discharged) that the borrower may have by contract or applicable law with respect to the loan or the provision of educational services for which the loan was received, against the school, its principals, its affiliates and their successors, or its sureties, and any private fund, including the portion of a public fund that represents funds received from a private party. If the borrower asserts a claim to, and recovers from, a public fund, the Secretary may reinstate the borrower's obligation to repay on the loan an amount based on the amount recovered from the public fund, if the Secretary determines that the borrower's recovery from the public fund was based on the same borrower defense and for the same loan for which the discharge was granted under this section.

(ii) The provisions of this paragraph (d)(12) apply notwithstanding any provision of State law that would otherwise restrict transfer of those rights by the borrower, limit or prevent a transferee from exercising those rights, or establish procedures or a scheme of distribution that would prejudice the Secretary's ability to recover on those rights.

(iii) Nothing in this paragraph (d)(12) limits or forecloses the borrower's right to pursue legal and equitable relief arising under applicable law against a party described in this paragraph (d)(12) for recovery of any portion of a claim exceeding that assigned to the Secretary or any other claims arising from matters unrelated to the claim on which the loan is discharged.

(13)(i) The Secretary may initiate an appropriate proceeding to require the school whose misrepresentation resulted in the borrower's successful borrower defense to pay to the Secretary the amount of the loan to which the defense applies in accordance with 34 CFR part 668, subpart G. This paragraph (d)(13) would also be applicable for provisionally certified institutions.

(ii) The Secretary will not initiate such a proceeding more than five years after the date of the final determination included in the written decision referenced in paragraph (d)(9) of this section. The Department will notify the school of the defense to repayment application.

(iii) The school must repay the Secretary the amount of the loan which has been discharged and amounts refunded to a borrower for payments made by the borrower to the Secretary, unless the school demonstrates that the Secretary's decision to approve the defense to repayment application was clearly erroneous.

* * * * *

■ 20. Section 685.212 is amended by adding paragraph (k) to read as follows:

§ 685.212 Discharge of loan obligation.

* * * * *

(k) *Borrower defenses.* (1) If a borrower's application for a discharge of a loan based on a borrower defense is approved under § 685.206(c) or (d), the Secretary discharges the obligation of the borrower, in whole or in part, in accordance with the procedures described in § 685.206(c) or (d), respectively.

(2) [Reserved]

* * * * *

■ 21. Section 685.214 is amended by:

■ a. Revising paragraphs (c)(1) introductory text through (c)(1)(i)(C).

■ b. Redesignating paragraphs (c)(1)(ii) and (iii) as paragraphs (c)(1)(iii) and (iv).

■ c. Adding a new paragraph (c)(1)(ii).

■ d. In paragraph (f)(1), removing the number ''120'' and adding, in its place, the number ''180''.

■ e. In paragraph (f)(4), removing the words ''the written request and sworn statement'' and adding, in their place, the words ''a completed application''.

The revisions and addition read as follows:

§ 685.214 Closed school discharge.

* * * * *

(c) *Borrower qualifications for discharge.* (1) In order to qualify for discharge of a loan under this section, a borrower must submit to the Secretary a completed application, and the factual assertions in the application must be true and made by the borrower under penalty of perjury. The application explains the procedures and eligibility criteria for obtaining a discharge and requires the borrower to—

(i) Certify that the borrower (or the student on whose behalf a parent borrowed)—

(A) Received the proceeds of a loan, in whole or in part, on or after January 1, 1986 to attend a school;

(B) Did not complete the program of study at that school because the school closed while the student was enrolled, or the student withdrew from the school not more than 180 days before the school closed. The Secretary may extend the 180-day period if the Secretary determines that exceptional circumstances related to a school's closing justify an extension. Exceptional circumstances for this purpose may include, but are not limited to: The revocation or withdrawal by an accrediting agency of the school's institutional accreditation, or revocation or withdrawal of the school's license to operate or to award academic credentials in the State; and

(C) Did not complete the program of study by transferring academic credits or hours earned at the closed school to another school;

(ii) Certify that the school did not provide the borrower an opportunity to complete the program of study in which the borrower was enrolled through a teach-out plan approved by the school's accrediting agency and, if applicable the school's State authorizing agency;

* * * * *

■ 22. Section 685.215 is amended by:

■ a. Revising paragraph (a)(1)(i).

■ b. Revising paragraphs (c) introductory text through (c)(1)(ii).

■ c. Revising paragraphs (d)(1) through (3).

The revisions read as follows:

§ 685.215 Discharge for false certification of student eligibility or unauthorized payment.

(a) * * *

(1) * * *

(i) Certified eligibility for a Direct Loan for a student who did not have a high school diploma or its recognized equivalent and did not meet the alternative eligibility requirements described in 34 CFR part 668 and section 484(d) of the Act applicable at the time of disbursement.

* * * * *

(c) *Borrower qualification for discharge.* In order to qualify for discharge under this section, the borrower must submit to the Secretary an application for discharge on a form approved by the Secretary, and the factual assertions in the application

must be true and made under penalty of perjury. In the application, the borrower must demonstrate to the satisfaction of the Secretary that the requirements in paragraphs (c)(1) through (6) of this section have been met.

(1) *High school diploma or equivalent.* (i) In the case of a borrower requesting a discharge based on not having had a high school diploma and not having met the alternative eligibility requirements, the borrower must certify that the borrower (or the student on whose behalf a parent borrowed)—

(A) Received a disbursement of a loan, in whole or in part, on or after January 1, 1986, to attend a school; and

(B) Received a Direct Loan at that school and did not have a high school diploma or its recognized equivalent, and did not meet the alternative to graduation from high school eligibility requirements described in 34 CFR part 668 and section 484(d) of the Act applicable at the time of disbursement.

(ii) A borrower does not qualify for a false certification discharge under § 685.215(c)(1) if—

(A) The borrower was unable to provide the school with an official transcript or an official copy of the borrower's high school diploma or the borrower was home schooled and has no official transcript or high school diploma; and

(B) As an alternative to an official transcript or official copy of the borrower's high school diploma, the borrower submitted to the school a written attestation, under penalty of perjury, that the borrower had a high school diploma.

* * * * *

(d) *Discharge procedures.* (1) If the Secretary determines that a borrower's Direct Loan may be eligible for a discharge under this section, the Secretary provides the borrower the application described in paragraph (c) of this section, which explains the qualifications and procedures for obtaining a discharge. The Secretary also promptly suspends any efforts to collect from the borrower on any affected loan. The Secretary may continue to receive borrower payments.

(2) If the borrower fails to submit a completed application within 60 days of the date the Secretary suspended collection efforts, the Secretary resumes collection and grants forbearance of principal and interest for the period in which collection activity was suspended. The Secretary may capitalize any interest accrued and not paid during that period.

(3) If the borrower submits a completed application the Secretary determines whether to grant a request for discharge under this section by reviewing the application in light of information available from the Secretary's records and from other sources, including, but not limited to, the school, guaranty agencies, State authorities, and relevant accrediting associations.

* * * * *

■ 23. Section 685.300 is amended by:

■ a. Revising paragraph (b)(8).

■ b. Removing the word ''and'' at the end of paragraph (b)(10).

■ c. Redesignating paragraph (b)(11) as paragraph (b)(12).

■ d. Adding a new paragraph (b)(11).

The revision and addition read as follows:

§ 685.300 Agreements between an eligible school and the Secretary for participation in the Direct Loan Program.

* * * * *

(b) * * *

(8) Accept responsibility and financial liability stemming from its failure to perform its functions pursuant to the agreement;

* * * * *

(11) Accept responsibility and financial liability stemming from losses incurred by the Secretary for repayment of amounts discharged by the Secretary pursuant to §§ 685.206, 685.214, 685.215, and 685.216; and

* * * * *

■ 24. Section 685.304 is amended by:

■ a. Revising paragraphs (a)(3)(iii) and (a)(5).

■ b. Removing the word ''and'' at the end of paragraph (a)(6)(xii).

■ c. Redesignating paragraph (a)(6)(xiii) as paragraph (a)(6)(xvi) and adding paragraphs (a)(6)(xiii), (xiv), and (xv).

The revision and additions read as follows:

§ 685.304 Counseling borrowers.

(a) * * *

(3) * * *

(iii)(A) Online or by interactive electronic means, with the borrower acknowledging receipt of the information.

(B) If a standardized interactive electronic tool is used to provide entrance counseling to the borrower, the school must provide to the borrower any elements of the required information that are not addressed through the electronic tool:

(*1*) In person; or

(*2*) On a separate written or electronic document provided to the borrower.

* * * * *

(5) A school must ensure that an individual with expertise in the title IV programs is reasonably available shortly after the counseling to answer the student borrower's questions. As an alternative, in the case of a student borrower enrolled in a correspondence, distance education, or study-abroad program approved for credit at the home institution, the student borrower may be provided with written counseling materials before the loan proceeds are disbursed.

(6) * * *

(xiii) If the school requires borrowers to enter into a pre-dispute arbitration agreement, as defined in § 668.41(h)(2)(iii) of this chapter, or to sign a class action waiver, as defined in § 668.41(h)(2)(i) and (ii) of this chapter, the school must provide a written description of the school's dispute resolution process that the borrower has agreed to pursue as a condition of enrollment, including the name and contact information for the individual or office at the school that the borrower may contact if the borrower has a dispute relating to the borrower's Federal student loans or to the educational services for which the loans were provided;

(xiv) If the school requires borrowers to enter into a pre-dispute arbitration agreement, as defined in § 668.41(h)(2)(iii) of this chapter, to enroll in the institution, provides a written description of how and when the agreement applies, how the borrower enters into the arbitration process, and who to contact if the borrower has any questions;

(xv) If the school requires borrowers to sign a class-action waiver, as defined in § 668.41(2)(h)(i) and (ii) of this chapter, to enroll in the institution, explain how and when the waiver applies, alternative processes the borrower may pursue to seek redress, and who to contact if the borrower has any questions; and

* * * * *

■ 25. Section 685.308 is amended by revising paragraph (a) to read as follows:

§ 685.308 Remedial actions.

(a) The Secretary may 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—

(1) The school's violation of a Federal statute or regulation;

(2) The school's negligent or willful false certification under § 685.215; or

(3) The school's actions that gave rise to a successful claim for which the Secretary discharged a loan, in whole or

in part, pursuant to §§ 685.206, 685.214, and 685.216.

* * * * *

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