



NACUBO's Response Proposed Rules on Borrower Defense to Repayment Summary • August 2016

Background. Under current law, students have a right to seek discharge of the federal Direct Loans they took out to attend a higher education institution if that school committed fraud; however, the rules do not establish any clear process for doing so. Very few student borrowers pursued this “borrower defense to repayment” until recently. Spurred by the large number of former Corinthian Colleges students seeking relief after the for-profit chain’s demise, the Department of Education (ED) in early 2016 began the process of creating a new borrower defense rule.

NACUBO firmly believes student borrowers should be protected from misleading, deceitful, and predatory practices of institutions. We support ED’s goal to establish borrower defense standards. In our comment letter, however, we raise serious concerns with several provisions in the proposed rules.

Definition of “Misrepresentation”

In the proposed rules, ED states that “substantial misrepresentation” can be a basis for a loan forgiveness claim if a borrower reasonably relied on certain information to decide to attend (or continue to attend) the institution. The definition ED proposes does not require knowledge or intent on the part of a school, and thus a claim can be made on unintentional or inadvertent statements. This places financial aid administrators, career counselors, and other staff in the position of guarding their words for fear of unintentionally creating a misrepresentation. The result will not be beneficial to students as it will likely lead to less guidance and advice generally being offered.

Unnecessary & Problematic “Triggers”

ED has added 10 “automatic triggers” that would apply to nonprofit institutions. If a school is subject to one or more of these triggers, ED would consider it unable to meet its financial or administrative obligations—without regard to the institution’s actual condition. The institution would then have to provide a letter of credit or other surety to the department and meet additional reporting and disclosure requirements.

Some triggers have nothing to do with the financial health of an institution. For example, one of the proposed triggers focuses on liabilities arising from various legal actions—including those not related to federal loans or educational services brought by government or other oversight entities.

NACUBO’s Top Concerns

1. ED’s expanded definition of “misrepresentation” permits borrower defense claims even when acts occurred unintentionally or inadvertently. Staff will have to constantly guard their words for fear of unintentionally creating a misrepresentation.
2. The department did not have the appropriate experts at the negotiated rulemaking table to develop reasonable regulations. Instead, ED has come up with financial responsibility regulations that have the potential to be burdensome to institutions and possibly harmful to current or prospective students.
3. The 10 new “automatic triggers” created by ED will not reliably address the deceptive, fraudulent practices that motivated this rulemaking effort. The dragnet goes too far and will needlessly threaten small, mission driven, nonprofit institutions.

NACUBO's Response

Proposed Rules on Borrower Defense to Repayment

Triggers (continued). In some cases ED includes legal action going back three years, and includes pending actions that have not yet been resolved. Another trigger focuses on cohort default rates, which are completely unrelated to an institution's financial responsibility.

Agreements with an institution's creditors.

ED is recommending that violations of provisions in borrowing agreements become the basis for an automatic trigger. ED's proposal can encompass any violation or event in a lending agreement that enables the creditor to make certain changes to the institution's obligations. An institution's debt agreements may include a number of events, unrelated to repayment performance, that trigger changes to terms. For example, changes to interest rates can be market driven and unrelated to an institution's payment performance. Under such circumstances it would be incorrect to assume that the institution is at fault, and unreasonable to assert the occurrence of a triggering event.

Materiality Thresholds & Accounting Terms.

ED has proposed a \$750,000 threshold for lawsuits and other actions related to federal loans or educational services, which is exceedingly low. When a materiality threshold is too low, insignificant events can be pulled into scope. This threshold is far below the levels independent auditors would use when forming an opinion on audited financial statements.

For other types of lawsuits or pending legal actions, an alternate threshold of 10 percent of current assets is proposed. The use of "current assets" is problematic; nonprofit institutions do not report current assets in their audited financial statements and the nonprofit definition of current assets is different than that of business entities.

Discretionary Triggers.

ED has proposed including additional, unclear discretionary triggers it might use, including a yet-to-be-determined financial stress test. Given ED's inability to calculate existing financial responsibility ratios, NACUBO has little confidence the financial stress would be assessed correctly.

ED also proposes to activate a discretionary trigger when an institution has a non-investment grade bond

rating. For a nonprofit institution, having a non-investment grade bond rating is not indicative of inability to repay debt or poor financial standing. Those that have a rating are arguably in better financial condition than those that do not.

Disclosures

Under the proposed rules, any school that is required to provide financial protection to ED would have to disclose that fact to current and prospective students on its home page. This would brand institutions as untrustworthy, driving away students and discouraging potential donors. Declines in enrollment and donor support will at best force tuition to rise and at worst could force some colleges to close.

Financial Experts Not Included

The proposed rules add significantly to the department's financial responsibility standards. These rules are designed to ensure schools are not at risk of precipitous closure.

ED did not disclose its intention to make changes to these rules, and stakeholders with financial expertise were not invited to participate in negotiated rulemaking. As a result, no financial experts, college or university business officers, independent auditors, or stakeholders that regularly use or analyze higher education's financial information were at the table.

Current Practices are Flawed

The existing financial responsibility practices should not be expanded until they are fixed.

NACUBO and others have found that the department is not calculating financial responsibility ratios for nonprofit institutions correctly—and has been doing it wrong for years.

Before imposing a new financial responsibility structure, ED should take steps to resolve existing problems.

NACUBO fully supports the undertaking by ED to go after institutions that are deceitful and have lied to or misled students. However, new, appropriate financial accountability rules should be put in place only after a fair and robust policy-making process.