DEPARTMENT OF EDUCATION

34 CFR Parts 30, 668, 674, 682, 685, and 686

RIN 1840-AD19

[Docket ID ED-2015-OPE-0103]

Student Assistance General Provisions, Federal Perkins Loan Program, Federal Family Education Loan Program, William D. Ford Federal Direct Loan Program, and Teacher Education Assistance for College And Higher Education Grant Program

AGENCY: Office of Postsecondary Education, Department of Education.

ACTION: Notice of proposed rulemaking.

SUMMARY: The Secretary proposes to amend the regulations governing the William D. Ford Federal Direct Loan (Direct Loan) Program to establish a new Federal standard and a process for determining whether a borrower has a defense to repayment on a loan based on an act or omission of a school. We propose to also amend the Direct Loan Program regulations by prohibiting participating schools from using certain contractual provisions regarding dispute resolution processes, such as mandatory pre-dispute arbitration agreements or class action waivers, and to require certain notifications and disclosures by schools regarding their use of arbitration. We propose to also amend the Direct Loan Program regulations to codify our current policy

regarding the impact that discharges have on the 150 percent Direct Subsidized Loan Limit. We also propose to amend the Student Assistance General Provisions regulations to revise the financial responsibility standards and add disclosure requirements for schools. Finally, we propose to amend the discharge provisions in the Federal Perkins Loan (Perkins Loan), Direct Loan, Federal Family Education Loan (FFEL), and Teacher Education Assistance for College and Higher Education (TEACH) Grant programs. The proposed changes would provide transparency, clarity, and ease of administration to current and new regulations and protect students, the Federal government, and taxpayers against potential school liabilities resulting from borrower defenses.

DATES: We must receive your comments on or before [INSERT DATE 45 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER].

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 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 U.S. Department of Education (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, room 6W232B, Washington, DC 20202.

Privacy Note: The Department's policy is to make all comments received from members of the public available for public viewing in their entirety 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, Barbara Hoblitzell at (202) 453-7583 or by email at: Barbara.Hoblitzell@ed.gov. For further information related to false certification and closed school loan discharges, Brian Smith at (202) 453-7440 or by email at: Brian.Smith@ed.gov. For further information regarding institutional accountability, John Kolotos or Greg Martin at (202) 453-7646 or (202) 453-7535 or by email at: John.Kolotos@ed.gov or Gregory.Martin@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 1-800-877-8339.

SUPPLEMENTARY INFORMATION:

Executive Summary:

Purpose of This Regulatory Action:

The purpose of the borrower defense regulation is to protect student loan borrowers from misleading, deceitful, and predatory practices of, and failures to fulfill contractual promises by, institutions participating in the Department’s student aid programs. Most postsecondary institutions provide a high-quality education that equips students with new knowledge and skills and prepares them for their careers. However, when postsecondary institutions make false and misleading statements to students or prospective students about school or career outcomes or financing needed to pay for those programs, or fail to fulfill specific contractual promises regarding program offerings or educational services, student loan borrowers may be eligible for discharge of their Federal loans.

The proposed regulations would give students access to consistent, clear, fair, and transparent processes to seek debt relief; protect taxpayers by requiring that financially risky institutions are prepared to take responsibility for losses to the government for discharges of and repayments for Federal student loans; provide due process for students and institutions; and warn students, using plain language issued by the Department, about proprietary schools at which the typical student experiences poor loan repayment outcomes--defined in these proposed regulations as a proprietary school with a loan repayment rate that is less than or equal to zero percent, which means that the typical borrower has not paid down at least a dollar on his or her loans--so that students can make more informed enrollment and financing decisions.

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 at §685.206(c) governing defenses to repayment have been in place since 1995 but, until recently, 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."

In response to the collapse of Corinthian Colleges (Corinthian) and the flood of borrower defense claims submitted by Corinthian students stemming from the school's misconduct, the Secretary announced in June 2015 that the Department would develop new regulations to establish a more accessible and consistent borrower defense standard and clarify and streamline the borrower defense process to protect borrowers and improve the Department's ability to hold schools accountable for actions and omissions that result in loan discharges.

Consistent with the Secretary's commitment, we propose regulations that would specify the conditions and processes under which a borrower may assert a defense to repayment of a Direct Loan, also referred to as a "borrower defense," based on a new Federal standard. The current standard allows borrowers to assert a borrower defense if a cause of action would have arisen under applicable state law. In contrast, the new Federal standard would allow a borrower to assert a borrower defense on the basis of a substantial misrepresentation, a breach of contract, or a favorable, nondefault contested judgment against the school for its act or omission relating to the making of the borrower's Direct Loan or the provision of educational services for which the loan was provided. The new standard would apply to loans made after the effective date of the proposed regulations. The proposed regulations would establish a process for borrowers to assert a borrower defense that would be implemented both for claims that fall under the existing standard and for later claims that fall under the new, proposed standard. In addition, the proposed regulations would 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 students, the Federal government, and taxpayers against potential institutional liabilities.

The Department also proposes a regulation that would prohibit a school participating in the Direct Loan Program from requiring, through the use of contractual provisions or other agreements, arbitration to resolve claims brought by a borrower against the school that could also form the basis of a borrower defense under the Department's regulations. The proposed regulations also would prohibit a school participating in the Direct Loan Program from obtaining agreement, either in an arbitration agreement or in another form, that a borrower waive his or her right to initiate or participate in a class action lawsuit regarding such claims and from requiring students to engage in internal institutional complaint or grievance procedures before contacting accrediting or government agencies with authority over the school regarding such claims. The proposed regulations also would prohibit a school participating in the Direct Loan Program from requiring, through the use of contractual provisions or other agreements, arbitration to resolve claims brought by a borrower against the school that could also form the basis of a borrower defense under the Department's regulations.

The proposed regulations would also impose certain notification and disclosure requirements on a school regarding claims that are voluntarily submitted to arbitration after a dispute has arisen.

Summary of the Major Provisions of This Regulatory Action: For the Direct Loan Program, we propose new regulations governing borrower defenses that would--

- Clarify that borrowers with loans first disbursed prior to July 1, 2017, may assert a defense to repayment under the current borrower defense State law standard;
- Establish a new Federal standard for borrower defenses, and limitation periods applicable to the claims asserted under that standard, for borrowers with loans first disbursed on or after July 1, 2017;
- Establish a process for the assertion and resolution of borrower defense claims made by individuals;
- Establish a process for group borrower defense claims with respect to both open and closed schools, including the conditions under which the Secretary may allow a claim to proceed without receiving an application;
- Provide for remedial actions the Secretary may take to collect losses arising out of successful borrower defense claims for which an institution is liable; and

- Add provisions to schools’ Direct Loan program participation agreements that, for claims that may form the basis for borrower defenses--

  - Prevent schools from requiring that students first engage in a school’s internal complaint process before contacting accrediting and government agencies about the complaint;

  - Prohibit the use of mandatory pre-dispute arbitration agreements by schools;

  - Prohibit the use of class action lawsuit waivers; and

  - To the extent schools and borrowers engage in arbitration in a manner consistent with applicable law and regulation, require schools to disclose to and notify the Secretary of arbitration filings and awards.

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

- Amend the definition of a misrepresentation to include omissions of information and statements with a likelihood or tendency to mislead under the circumstances. The definition would be amended for misrepresentations for which the Secretary may impose a fine, or limit, suspend, or terminate an institution’s participation in title IV, HEA programs. This definition is also adopted as a basis for alleging borrower defense claims for Direct Loans first disbursed after July 1, 2017;

- Clarify that a limitation may include a change in an institution’s participation status in title IV, HEA programs from fully certified to provisionally certified;

- Amend the financial responsibility standards to include actions and events that would trigger a requirement that a school provide financial protection, such as a letter of credit, to insure against future borrower defense claims and other liabilities to the Department;

- Require proprietary schools with a student loan repayment rate that is less than or equal to zero percent to provide a Department-issued plain language warning to prospective and enrolled students and place the warning on its Web site and in all promotional materials and advertisements; and

- Require a school to disclose on its Web site and to prospective and enrolled students if it is required to provide financial protection, such as a letter of credit, to the Department.

The proposed regulations would also--

- Expand the types of documentation that may be used for the granting of a discharge based on the death of the borrower ("death discharge") in the Perkins, FFEL, Direct Loan, and TEACH Grant programs;
- Revise the Perkins, FFEL, and Direct Loan closed school discharge regulations to ensure borrowers are aware of and able to benefit from their ability to receive the discharge;
- Expand the conditions under which a FFEL or Direct Loan borrower may qualify for a false certification discharge;
- Codify the Department's current policy regarding the impact that a discharge of a Direct Subsidized Loan has on the 150 Percent Direct Subsidized Loan Limit; and
- Make technical corrections to other provisions in the FFEL and Direct Loan Program regulations and to the regulations governing the Secretary's debt compromise authority.

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 the borrower defense rule and to increase protections for students as well as taxpayers and the Federal government; (2) increased financial protections for the Federal government and thus for taxpayers; (3) additional information to help students, prospective students, and their families make educated decisions based on information about an institution’s financial soundness and its borrowers’ loan repayment outcomes; (4) improved conduct of schools by holding individual institutions accountable and thereby deterring misconduct by other schools; (5) improved awareness and usage, where appropriate, of closed school and false certification discharges; and (6) technical changes to improve the administration of the title IV, HEA programs. Costs include paperwork burden associated with the required reporting and disclosures to ensure compliance with the proposed regulations, the cost to affected institutions of providing financial protection, and the cost to taxpayers of borrower defense claims that are not reimbursed by institutions.

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., Washington, DC 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 §§30.70, 668.14, 668.41, 668.71, 668.90, 668.93, 668.171, 668.175, 674.33, 674.61, 682.202, 682.211, 682.402, 682.405, 682.410, 685.200, 685.205, 685.206, 685.209, 685.212, 685.214, 685.215, 685.200, 685.220, 685.300, 685.308, and 686.42 of title 34 of the Code of Federal Regulations (CFR), and also to add new §§668.176, 685.222, 685.223, and 685.310 to that title. The regulations in 34 CFR part 30 pertain to Debt Collection. 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. The regulations in 34 CFR part 686 pertain to the TEACH Grant Program. We are proposing these amendments to: (1) specify that the standards used to identify an act or omission of a school that provides the basis for a borrower defense will depend on when the Direct Loan was first disbursed; (2) establish a new Federal standard and limitation periods that the Department will use to identify an act or omission of an institution that constitutes a borrower defense; (3) establish the procedures to be used for a borrower to initiate a borrower defense; (4) establish the standards and certain procedures that the Department would use to determine the liability of an institution for the amount of relief arising from a borrower defense; (5) prohibit schools' use of mandatory pre-dispute arbitration agreements or class action bans to resolve disputes for claims that could also form the basis of borrower defense claims or require borrowers to waive any rights to initiate or participate in class actions regarding such claims; and impose certain notification and disclosure requirements relating to a school's use of arbitration; (6) 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 thus taxpayers, against potential institutional liabilities; (7) require a proprietary institution with a student loan repayment rate that is less than or equal to zero percent to place a Department-issued plain language warning on its Web site and in advertising and promotional materials, as well as to provide the warning to prospective and enrolled students; (8) require that a school disclose to prospective and enrolled students if it is required to provide financial protection to the Department; (9) expand the allowable documentation that may be submitted to demonstrate eligibility for a death discharge of a title IV, HEA loan or a TEACH Grant service obligation; (10) revise the closed school discharge regulations to ensure borrowers are aware of and able to benefit from their ability to receive the discharge; (11) expand the eligibility criteria for the false certification loan discharge; (12) make technical corrections to the regulation that describes the authority of the Department to compromise, or suspend or terminate collection of, debts; (13) make technical corrections to the regulations governing the Pay as You Earn (PAYE) and Revised Pay as You Earn (REPAYE) repayment plans; (14) allow for the consolidation of Nurse Faculty Loans; (15) allow borrowers to obtain a Direct Consolidation Loan if the borrower consolidates at least one of the eligible loans listed in §685.220(b); (16) clarify the conditions under which the capitalization of interest by FFEL Program loan holders is permitted; and (17) codify 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.

Public Participation

On August 20, 2015, we published a notice in the Federal Register (80 FR 50588) announcing our intent to establish a negotiated rulemaking committee under section 492 of the HEA to develop proposed regulations for determining which acts or omissions of an institution of higher education ("institution" or "school") a borrower may assert as a borrower defense under the Direct Loan Program and the consequences of such borrower defenses for borrowers, institutions, and the Secretary. We also announced two public hearings at which interested parties could comment on the topic suggested by the Department and suggest additional topics for consideration for action by the negotiated rulemaking committee. The hearings were held on--

September 10, 2015, in Washington, DC; and

September 16, 2015, in San Francisco, CA.

Transcripts from the public hearings are available at www2.ed.gov/policy/highered/reg/hearulemaking/2016/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 August 20, 2015, Federal Register notice may be viewed through the Federal eRulemaking Portal at www.regulations.gov, within docket ID ED-2015-OPE-0103. Instructions for finding comments are also available on the site under "How to Use Regulations.gov" in the Help section.

On October 20, 2015, we published a notice in the Federal Register (80 FR 63478) requesting nominations for negotiators to serve on the negotiated rulemaking committee and setting a schedule for committee meetings.

On December 21, 2015, we published a notice in the Federal Register (80 FR 79276) requesting additional nominations for negotiators to serve on the negotiated rulemaking committee.

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 October 20, 2015, the Department published a notice in the Federal Register (80 FR 63478) announcing its intention to establish a negotiated rulemaking committee to prepare proposed regulations governing the Federal Student Aid programs authorized under title IV of the HEA. The notice set forth a schedule for the committee meetings and requested nominations for individual negotiators to serve on the negotiating committee.

The Department sought negotiators to represent the following groups: students/borrowers; legal assistance organizations that represent students/borrowers; consumer advocacy organizations; groups representing U.S. military servicemembers or veteran Federal loan borrowers; financial aid administrators at postsecondary institutions; State attorneys general (AGs) 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, for-profit institutions of higher education; FFEL Program lenders and loan servicers; and FFEL Program guaranty agencies and guaranty agency servicers (including collection agencies). The Department considered the nominations submitted by the public and chose negotiators who would represent the various constituencies.

On December 21, 2015, the Department published a notice in the Federal Register (80 FR 79276) requesting additional nominations for negotiators to serve on the negotiated rulemaking committee to represent constituencies that were not represented following the initial request for nominations. The Department sought negotiators to represent the following groups: 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; two-year public institutions of higher education; private, for-profit institutions of higher education; and national, regional, or specialized accrediting agencies.

The negotiating committee included the following members:

Ann Bowers, for-profit college borrower, and Chris Lindstrom (alternate), U.S. Public Interest Research Group, representing students/borrowers.

Noah Zinner, Housing and Economic Rights Advocates, and Eileen Connor (alternate), Project on Predatory Student Lending at Harvard Law School (at the time of nomination, New York Legal Assistance Group) representing legal assistance organizations that represent students.

Maggie Thompson, Higher Ed, Not Debt, and Margaret Reiter (alternate), attorney, representing consumer advocacy organizations.

Bernard Eskandari, Office of the Attorney General of California, and Mike Firestone (alternate), Commonwealth of Massachusetts Office of the Attorney General, representing State attorneys general and other appropriate State officials.

Walter Ochinko, Veterans Education Success, Will Hubbard (first alternate), Student Veterans of America, and Derek Fronabarger (second alternate), Student Veterans of America, representing U.S. military servicemembers or veterans.

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

Becky Thompson, Washington Student Achievement Council, representing State higher education executive officers.

Alyssa Dobson, Slippery Rock University, and Mark Justice (alternate), The George Washington University, representing financial aid administrators.

Sharon Oliver, North Carolina Central University, and Emily London Jones (alternate), Xavier University of Louisiana, representing minority-serving institutions.

Angela Johnson, Cuyahoga Community College, and Shannon Sheaff (alternate), Mohave Community College, representing two-year public institutions.

Kay Lewis, University of Washington, and Jean McDonald Rash (alternate), Rutgers University, representing four-year public institutions.

Christine McGuire, Boston University, and David Sheridan (alternate), Columbia University, representing private, nonprofit institutions.

Dennis Cariello, Hogan Marren Babbo & Rose, Ltd., and Chris DeLuca (alternate), DeLuca Law, representing private, for-profit institutions.

Wanda Hall, EdFinancial Services, and Darin Katzberg (alternate), Nelnet, representing FFEL Program lenders and loan servicers.

Betsy Mayotte, American Student Assistance, and Jaye O'Connell (alternate), Vermont Student Assistance Corporation, representing FFEL Program guaranty agencies and guaranty agency servicers.

Gail McLarnon, U.S. Department of Education, representing the Department.

The negotiated rulemaking committee met to develop proposed regulations on January 12-14, 2016, February 17-19, 2016, and March 16-18, 2016. The Department held informational sessions by telephone for interested members of the committee on March 1 and March 3, 2016, to review the Department's loan repayment rate disclosure proposal, and on March 9 and March 10, 2016, at the request of a non-Federal negotiator, to hear from Professor Adam Zimmerman of Loyola Law School regarding agency class settlement processes.

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 seven issues related to student financial aid. These seven issues were: borrower defenses, false certification discharges, institutional accountability, electronic death certificates, consolidation of Nurse Faculty Loans, interest capitalization, and technical corrections to the PAYE and REPAYE plans. During the second meeting, the negotiating committee agreed to add two additional issues: closed school discharges and a technical correction to the regulations that describe the authority of the Department to compromise, or suspend, or terminate collection of, debts. Under the protocols, a final consensus would have to include consensus on all nine issues.

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 March 18, 2016, 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 or 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: http://www2.ed.gov/policy/highered/reg/hearulemaking/2016/index.html.

Summary of Proposed Changes

The proposed regulations would--

- Amend §685.206 to clarify that existing regulations with regard to borrower defenses apply to loans first disbursed prior to July 1, 2017, and that a borrower defense asserted pursuant to this section will be subject to the procedures in proposed §685.222(e) to (k);
- Amend §685.206 to remove the period of limitation on the Secretary's ability to recover from institutions the amount of the losses incurred by the Secretary on loans to which an approved borrower defense applies;

- Amend §685.206 to clarify that a borrower defense may be asserted as to an act or omission of the school that relates to the making of the loan or the provision of educational services that would give rise to a cause of action against the school under applicable State law;

- Add a new borrower defense section at §685.222 that applies to loans first disbursed on or after July 1, 2017;

- Provide in §685.222(a) that a borrower defense may be established if a preponderance of the evidence shows that the borrower has a borrower defense claim that relates to the making of the borrower's Direct Loan or the provision of educational services and meets the requirements in §685.222(b), (c), or (d);

- Provide in §685.222(a) that a violation by a school of an eligibility or compliance requirement in the HEA or its implementing regulations is not a basis for a borrower defense;

- Define in §685.222(a) the terms "borrower" and "borrower defense";

- Amend the definition of "misrepresentation" in §668.71 to define a misleading statement as one that "includes any statement that has the likelihood or tendency to mislead under the circumstances" and to include "any statement that omits information in such a way as to make the statement false, erroneous, or misleading”;

- Establish in §685.222(b), (c), and (d) a new Federal standard upon which a borrower defense may be based--a judgment against the school, a breach of contract by the school, or a substantial misrepresentation by the school;

- Provide in §685.222(d)(2) that in determining whether a school made a substantial misrepresentation, the Secretary may consider certain factors as to whether the reliance of a borrower on the misrepresentation was reasonable; ;

- Establish in §685.222(e) a procedure under which an individual borrower may assert a borrower defense;

- Provide in §685.222(f) a general description of a group borrower defense claim process, including the conditions under which the Secretary may allow a claim to proceed without receiving an application;

- Establish in §685.222(g) and (h) processes for borrower defense claims made by groups of borrowers with respect to closed schools and open schools, respectively;

- Specify in §685.222(i) that the relief granted to a borrower with an approved borrower defense is based on the facts underlying the borrower’s claim;

- Require in §685.222(j) and (k) cooperation by the borrower in any borrower defense proceeding and, upon the granting of relief to a borrower, provide for the transfer to the Secretary of the borrower's right to recovery against third parties;
- Add a new paragraph (k) to §685.212 to include an approved borrower defense among the reasons for a discharge of a loan obligation, and to address borrower defense claims on Direct Consolidation Loans;
- Amend §685.205 to expand the circumstances under which the Secretary grants forbearance without requiring documentation from the borrower to include periods of time when a borrower defense has been asserted and is under review;
- Amend §685.300 to prevent schools from requiring that students first engage in a school's internal complaint process before contacting accrediting and government agencies about the complaint; prohibit the use of pre-dispute mandatory arbitration agreements by schools; prohibit the use of class action lawsuit waivers; and require schools to disclose to and notify the Secretary of arbitration filings;

- Clarify in §685.308 that the Secretary may recover from the school losses from loan discharges, including losses incurred from approved borrower defenses;
- Amend §668.171 to include conditions and events that trigger a requirement that the school provide financial protection, such as a letter of credit. Such conditions and events include incurring significant amounts of liability in recent years for borrower defense claim losses, a school's inability to pay claims, and events that would compromise a school's ability to continue its participation in the title IV, HEA programs;
- Require in §668.41 a proprietary school with a student loan repayment rate that is less than or equal to zero percent to place a Department-issued plain language warning on its Web site and in advertising and promotional materials, as well as to provide the warning to prospective and enrolled students;
- Require in §668.41 that a school disclose to prospective and enrolled students if it is required to provide financial protection, such as a letter of credit, to the Department;
- Amend §668.175 to state the amounts of financial protection, such as letters of credit, required in the event of particular occurrences;

- Clarify in §668.90 when a hearing official must uphold the limitation or termination requested by the Secretary for disputes related to the amount of financial protection, such as a letter of credit, for a school's failure under the financial responsibility standards;
- Clarify in §668.93 that a limitation sought by the Secretary on a school's participation in title IV, HEA programs may include a change in participation from fully certified to provisionally certified;
- Amend §§674.61, 682.402, 685.212, and 686.42 to allow for a death discharge of a loan or TEACH Grant service obligation to be granted based on an original or certified copy of a death certificate that is submitted electronically or sent by facsimile transmission, or through verification of death in an electronic Federal or State database that is approved for use by the Secretary;
- Amend §§668.14(b), 674.33(g), 682.402(d), and 685.214(f) to increase outreach by the Secretary and schools and make more information available to borrowers eligible for a closed school discharge so that they are aware of this option;
- Amend §685.215 to update and expand the existing categories of false certification discharge to include the improper certification of eligibility of a student who is

not a high school graduate and false certification of a borrower's academic progress;

- Amend §682.211 to require lenders to grant a mandatory administrative forbearance for borrowers who have filed a borrower defense claim with the Secretary with the intent of seeking relief under §685.212(k) after consolidating into the Direct Loan Program;
- Update the provisions in §30.70 to reflect the increased debt resolution authority provided in Pub. L. 101-552 that authorizes the Department to resolve debts up to $100,000 without approval from the Department of Justice (DOJ) as well as other changes to the Department's claim resolution authority;
- Amend §685.209 by making technical corrections and clarifying changes to the PAYE and REPAYE repayment plan regulations;
- Amend §685.220 to allow a borrower to obtain Direct Consolidation Loan, if the borrower consolidates any of the eligible loans listed in §685.220(b); and
- Clarify in §§682.202, 682.405, and 682.410 that guaranty agencies and FFEL Program lenders are not permitted to capitalize outstanding interest on FFEL loans when the borrower rehabilitates a defaulted FFEL loan; and

- Amend §685.200 to codify the Department’s current practice regarding the elimination or recalculation of a subsidized usage period or the restoration of interest subsidy under the 150 Percent Direct Subsidized Loan Limit when a Direct Subsidized Loan is discharged.

Significant Proposed Regulations

We group major issues according to subject, with the applicable sections of the proposed regulations referenced in parentheses. We discuss other 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.

Borrower Defenses (§§668.71, 685.205, 685.206, and 685.222)

Background: The proposed regulations address several topics related to the administration of title IV, HEA student aid programs and benefits and options for borrowers. The Department first implemented borrower defense regulations for the Direct Loan Program in the 1995-1996 academic year to protect borrowers. The Department’s original intent was for this rule to be in place for the 1995-1996 academic year, and then to develop a more extensive rule for both the Direct Loan and FFEL Loan programs through negotiated rulemaking in the following year.

However, based on the recommendation of non-Federal negotiators in the spring of 1995, the Secretary decided not to develop further regulations for the Direct Loan and FFEL programs. 60 FR 37768. As a result, the regulations have not been updated in two decades to establish appropriate processes or other necessary information to allow borrowers to effectively utilize their options under the borrower defense regulation.

In May 2015, Corinthian, a publicly traded company operating numerous postsecondary schools that enrolled over 70,000 students at more than 100 campuses nationwide, filed for bankruptcy. Corinthian collapsed under deteriorating financial conditions and while subject to multiple State and Federal investigations, one of which resulted in a finding by the Department that the college had misrepresented its job placement rates. Upon the closure of Corinthian, which included Everest Institute, Wyotech, and Heald College, the Department received thousands of claims for student loan relief from Corinthian students.

The Department is committed to ensuring that students harmed by Corinthian's fraudulent practices receive the relief to which they are entitled under the current closed school and borrower defense regulations. The Department appointed a Special Master in June 2015 to create and oversee a process to provide debt relief for these Corinthian borrowers who applied for Federal student loan discharges based on claims against Corinthian.

The current borrower defense regulation, which has existed since 1995 but has rarely been used, requires a borrower to demonstrate that a school's acts or omissions would give rise to a cause of action under "applicable State law." The regulation is silent on the process a borrower follows to assert a borrower defense claim.

The landscape of higher education has changed significantly over the past 20 years. The role of distance education in the higher education sector has grown substantially. In the 1999-2000 academic year, about eight percent of students were enrolled in at least one distance education course; by the 2007-2008 academic year, that number had grown to 20 percent.[1] Recent IPEDS data indicate that in the fall of 2013, 26.4 percent of students at degree-granting, title IV-participating institutions were enrolled in at least one distance education class.[2] Much of this growth occurred within and coincided with the growth

[1] Learning at a Distance: Undergraduate Enrollment in Distance Education Courses and Degree Programs (http://nces.ed.gov/pubs2012/2012154.pdf).
[2] 2014 Digest of Education Statistics: Table 311.15: Number and percentage of students enrolled in degree-granting postsecondary institutions, by distance education participation, location of student, level of enrollment, and control and level of institution: Fall 2012 and fall 2013.

of the proprietary higher education sector. In the fall of 1995, degree-granting, for-profit institutions enrolled approximately 240,000 students. In the fall of 2014, degree-granting, for-profit schools enrolled over 1.5 million students.[3] These changes to the higher education industry have allowed students to enroll in colleges based in other States and jurisdictions with relative ease.

These changes have had an impact on the Department's ability to apply its borrower defense regulations. The current borrower defense regulations do not identify which State's law is considered "applicable" State law on which the borrower's claim can be based.[4] Generally, the regulation was assumed to refer to the laws of the State in which the institution was located; we had little occasion to address differences in protection for borrowers in States that offer little protection from school misconduct or borrowers who reside in one State but are enrolled via distance education in a program based in another State. Some States have extended their rules to protect these

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[3] 2015 Digest of Education Statistics: Table 303.10: Total fall enrollment in degree-granting postsecondary institutions, by attendance status, sex of student, and control of institution: Selected years, 1947 through 2025- http://nces.ed.gov/programs/digest/d14/tables/dt14_303.10.asp?current=yes.

[4] In the few instances in which claims have been recognized under current regulations, borrowers and the school were typically located in the same State.

students, while others have not. As a result of the difficulties in application and interpretation of the current State law standard, as well as the lack of clarity surrounding the procedures that apply for borrower defense, the Department took additional steps to improve the borrower defense claim process.

In a Federal Register notice published on October 20, 2015 (80 FR 63478), the Department announced its intent to establish a negotiated rulemaking committee to develop proposed regulations that establish, among other items, the criteria that the Department will use to identify acts or omissions of an institution that constitute, for borrowers of Federal Direct Loans, a borrower defense, including a Federal standard, the procedures to be used for a borrower to establish a borrower defense, and the standards and procedures that the Department will use to determine the liability of the institution for losses arising from approved borrower defenses.

We propose to create a new §685.222, and amend §§668.71, 685.205, and 685.206, to establish, effective July 1, 2017, a new Federal standard for borrower defenses, new limitation periods for asserting borrower defenses, and processes for the assertion and resolution of borrower defense claims. In the following sections, we describe in more detail these proposed changes and other clarifying changes proposed to improve the borrower defense process.

Borrower Defenses--General (§685.222(a))

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.

Section 487 of the HEA provides that the Secretary can take enforcement action against an institution participating in the title IV, HEA programs that substantially misrepresents the nature of the institution's education program, its financial charges, or the employability of its graduates.

Current Regulations: Section 685.206(c) establishes the conditions under which a Direct Loan borrower may assert a borrower defense, the relief afforded by the Secretary in the event the borrower's claim is successful, and the Secretary's authority to recover from the school any loss that results from a successful borrower defense. Specifically, §685.206(c) provides that a borrower defense may be asserted 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 current regulations in §685.206(c) are described in more detail under "Borrower Responsibilities and Defenses (34 CFR 685.206)."

Proposed Regulations: Proposed §685.222(a) would provide that borrower defense claims asserted by a borrower for Direct Loans first disbursed before July 1, 2017, are considered by the Secretary in accordance with the provisions of §685.206(c), while borrower defense claims asserted by a borrower for Direct Loans first disbursed on or after July 1, 2017, will be considered by the Secretary in accordance with the provisions of §685.222.

For borrower defense claims asserted by a borrower for Direct Loans first disbursed on or after July 1, 2017, proposed §685.222 would establish a new Federal standard and new limitation periods. Proposed §685.222 would also establish a process for the assertion and resolution of all borrower defense claims--both those made under §685.206(c) for Direct Loans first disbursed prior to July 1, 2017, and for those made under proposed §685.222. We describe the proposed regulations relating to the new Federal standard and new limitation periods under "Federal Standard and Limitation Periods (34 CFR 685.222(b), (c), and (d) and 34 CFR 668.71)," and the borrower defense claim process under "Process for Individual Borrowers (34 CFR 685.222(e))," "Group Process for Borrower Defenses--General (34 CFR

685.222(f)),” “Group Process for Borrower Defenses--Closed School (34 CFR 685.222(g)),” and “Group Process for Borrower Defense Claims--Open School (34 CFR 685.222(h)).”

For borrower defense claims asserted by a borrower for Direct Loans first disbursed on or after July 1, 2017, proposed §685.222(a)(2) would provide that a preponderance of the evidence must show that the borrower has a borrower defense that relates to the making of the borrower’s Direct Loan or the provision of educational services by the school to the student and that meets the requirements under §685.222(b), (c), or (d), which are described in detail under ”Federal Standard and Limitation Periods (34 CFR 685.222(b), (c), and (d) and 34 CFR 668.71).”

Section 685.222(a)(3) would clarify that a violation by the school of an eligibility or compliance requirement in the HEA or its implementing regulations is not a basis for a borrower defense unless that conduct would by itself, and without regard to the fact that the conduct violated an HEA requirement, give rise to a cause of action against the school under either applicable State law or under the new Federal standard, whichever is applicable depending on the first disbursement date of the Direct Loan in question.

Proposed §685.222(a)(4) would define “borrower” and “borrower defense.” Under the proposed definitions, “borrower” would mean the borrower and, in the case of a Direct PLUS Loan, the student and any endorsers. Under proposed §685.222(a)(5), “borrower defense” would include one or both of the following: a defense to repayment of amounts owed to the Secretary on a Direct Loan, in whole or in part; and a right to recover amounts previously collected by the Secretary on the Direct Loan, in whole or in part.

If the borrower asserts both a borrower defense under §685.222 and any other objection to an action of the Secretary with regard to the Direct Loan at issue (such as a claim for a closed school discharge or false certification discharge), the Secretary would notify the borrower of the order in which the Secretary considers the borrower defense and any other objections. The order in which the Secretary will consider objections, including borrower defense, would be determined by the Secretary as appropriate under the circumstances.

Reasons: We propose to establish in §685.222 a new Federal standard and new limitation periods for borrower defense claims asserted with respect to loans first disbursed after the expected effective date of these proposed regulations--July 1, 2017--as well as a process for the assertion and resolution of all borrower defense claims, both those made under proposed §685.206(c) and those made under proposed §685.222. The Department believes that the proposed changes could reduce the number of borrowers who are struggling to meet their student loan obligations. During the public comment periods of the negotiated rulemaking sessions, many public commenters who were borrowers mentioned that they believed that they had been defrauded by their institutions of higher education and were unable to pay their student loans or obtain debt relief under the current regulations. For instance, many of these borrowers stated that they had relied upon the misrepresentation by their school as to employment outcomes, but later found out that they were unable to secure employment as had been represented to them before their enrollment.

We discuss more specifically our reasons for adopting a new Federal standard and limitation periods under the discussion of "Federal Standard and Limitation Periods (34 CFR 685.222(b), (c), and (d) and 34 CFR 668.71)." We discuss our reasons for establishing a borrower defense claim process under "Process for Individual Borrowers (34 CFR 685.222(e)," "Group Process for Borrower Defenses - General (34 CFR 685.222(f)," "Group Process for Borrower Defenses - Closed School (34 CFR 685.222(g)," and "Group Process for Borrower Defense Claims - Open School (23 CFR

685.222(h)." We explain why the borrower defense regulations apply only to the Direct Loan Program under "Discharge of a Loan Obligation (§685.212)."

Proposed §685.222(a) would establish provisions of general applicability for borrower defense claims. As noted above, we would clarify in paragraphs (a) and (b) of that section that borrower defense claims for loans disbursed before July 1, 2017, are made under §685.206(c) and that borrower defense claims for loans disbursed on or after July 1, 2017, are made under proposed §685.222. Although proposed §685.206(c) also would specify that it applies to borrower defense claims for loans disbursed before July 1, 2017, we believe that also stating the general framework in §685.222 would help eliminate any confusion as to which standard applies.

In proposed §685.222(a)(2) and (5), we would establish the basic elements of borrower defense claims for loans disbursed on or after July 1, 2017. Specifically, proposed §685.222(a)(2) and (5) would require that a borrower defense claim:

- Is supported by a preponderance of the evidence;
- Relates to the making of the borrower's Direct Loan or the provision of educational services; and

- Meets the requirements under paragraph (b), (c), or (d) of the section.

In addition, proposed §685.222(a)(2) would clarify that a claim may be brought by a borrower to discharge amounts owed to the Secretary on a Direct Loan, in whole or in part, or to recover amounts previously collected by the Secretary on the Direct Loan, in whole or in part, or both.

A claim is supported by a “preponderance of the evidence” if there is sufficient evidence produced to persuade the decision maker that it is more likely than not that something happened or did not happen as claimed. In practice, the decision maker in a borrower defense proceeding would measure the value, or weight, of the evidence (including attestations, testimony, documents, and physical evidence) produced to prove that the borrower defense claim as alleged is true. We believe this evidentiary standard is appropriate as it is the typical standard in most civil proceedings. Additionally, the Department uses a preponderance of the evidence standard in other processes 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. We discuss the types of evidence that may be presented in support of a claim under "Process for Individual Borrowers (34 CFR 685.222(e))."

Proposed §685.222 would clarify that, whether a borrower defense is brought under the standard described in §685.206(c) or the standards in proposed §685.222(b), (c), and (d), the Department's position is that it will acknowledge a borrower defense asserted under the regulations "only if the cause of action directly relates to the loan or to the school's provision of educational services for which the loan was provided." 60 FR 37768, 37769. Such claims may include, for example, fraud in the making of the Direct Loan in the course of student recruitment or a failure to provide educational services. In some circumstances, this may include post-enrollment services like career advising or placement services. The Department does not recognize as a defense against repayment of the loan a cause of action that is not directly related to the loan or to the provision of educational services, such as personal injury tort claims or actions based on allegations of sexual or racial harassment. Id. The proposed language is consistent with this longstanding position and is also reflected in similar proposed language for §685.206(c). Non-Federal negotiators also requested clarification on whether borrower defenses may be asserted as to tort claims asserting that educational institutions and their employees breached their duty to educate students adequately (otherwise known as "educational malpractice"), or to issues relating to academic and disciplinary disputes. Courts that have considered claims characterized as educational malpractice have generally concluded that State law does not recognize such claims.[5] The Department does not intend in these regulations to create a different legal standard, and for existing loans would apply that same principle under §685.206(c), and would maintain that same position in applying the standards proposed in §685.222. Claims relating to the quality of a student's education or matters regarding academic and disciplinary disputes within the judgment and discretion of a school are outside the scope of the borrower defense regulations. The Department recognizes, however, that in certain circumstances, such as

[5] See Bell v. Board of Educ. of City of West Haven, 55 Conn. App. 400, 739 A.2d 321, 139 Ed. Law Rep. 538 (1999), noting that the vast majority of courts have refused to recognize a cause of action for educational malpractice; Sain v. Cedar Rapids Cmty. Sch. Dist., 626 N.W.2d 115, 121 (Iowa 2001)(Educational malpractice almost universally rejected as a cause of action).

where a school may make specific misrepresentations about its facilities, financial charges, programs, or employability of its graduates, such misrepresentations may function as the basis of a borrower defense as opposed to being a claim regarding educational quality.[6] Additionally, a breach of contract borrower defense may be raised where a school has failed to deliver specific obligations, such as programs and services, it has committed to by contract. The Department also notes that the limitations of the scope of the borrower defense regulations should not be taken to represent any view that other issues are not properly the concern of the Department as well as other Federal agencies, State authorizers and other State agencies, accreditors, and the courts.

With regard to the other required elements of a borrower defense claim, we discuss our reason for requiring a borrower defense to meet the requirements under paragraphs (b), (c), and (d) of proposed §685.222 under "Federal Standard and Limitation Periods (34 CFR 685.222(b), (c), and (d) and 34 CFR 668.71)."

Proposed §685.222(a)(3) would set forth the Department's longstanding position that an act or omission

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[6] See, e.g., Sain v. Cedar Rapids Cmty. Sch. Dist., 626 N.W.2d 115, 121 (Iowa 2001), recognizing that tort of negligent misrepresentation applicable in education context.

by the school that violates an eligibility or compliance requirement in the HEA or its implementing regulations does not necessarily affect the enforceability of a Federal student loan obtained to attend the school, and is not, therefore, automatically a basis for a borrower defense.[7] The HEA vests the Department with the sole authority to determine and apply the appropriate sanction for HEA violations. A school's act or omission that violates the HEA may, of course, give rise to a cause of action under other law, and that cause of action may also independently constitute a borrower defense claim under §685.206(c) or proposed §685.222. For example, advertising that makes untruthful statements about placement rates violates section 487(a)(8) of the HEA, but may also give rise to a

[7] As stated by the Department in 1993:

> [The Department] considers the loss of institutional eligibility to affect directly only the liability of the institution for Federal subsidies and reinsurance paid on those loans.... [T]he borrower retains all the rights with respect to loan repayment that are contained in the terms of the loan agreements, and [the Department] does not suggest that these loans, whether held by the institution or the lender, are legally unenforceable merely because they were made after the effective date of the loss of institutional eligibility.

58 FR 13337. Armstrong v. Accrediting Council for Continuing Educ. & Training, Inc., 168 F.3d 1362, 1369 (D.C. Cir. 1999), opinion amended on denial of reh'g, 177 F.3d 1036 (D.C. Cir. 1999) (rejecting claim of mistake of fact regarding institutional accreditation as grounds for rescinding loan agreements).

cause of action under common law based on misrepresentation[8] or constitute a substantial misrepresentation under the new Federal standard and, therefore, constitute a basis for a borrower defense claim.

In proposed §685.222(a)(4), we propose to define "borrower" to provide clarity and to include all parties who may be responsible for repaying the Secretary for a Direct Loan to which a borrower defense claim relates or who are otherwise harmed.

In proposed §685.222(a)(5), "borrower defense" is defined to include one or both of the following: a defense to repayment of amounts owed to the Secretary on a Direct Loan, in whole or in part; and a right to recover amounts previously collected by the Secretary on the Direct Loan, in whole or in part. Currently, the existing regulation for borrower defense at §685.206(c) allows for reimbursement of amounts paid towards a loan as possible further relief, in addition to a discharge of any remaining loan obligation, for approved borrower defenses. The Department believes that the proposed definition will more accurately capture borrowers' requests for and the

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[8] See, e.g., Moy v. Adelphi Inst., Inc., 866 F. Supp. 696, 706 (E.D.N.Y. 1994)(upholding claim of common law misrepresentation based on false statements regarding placement rates.)

Secretary's ability to offer relief through the borrower defense process--for both a discharge of any remaining loan obligation and for reimbursement of amounts paid to the Secretary for the loan that is the subject of an approved borrower defense.

Federal Standard and Limitation Periods (§685.222(b), (c), and (d) and §668.71)

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.

Section 487 of the HEA provides that institutions participating in the title IV, HEA programs shall not engage in substantial misrepresentation of the nature of the institution's education program, its financial charges, or the employability of its graduates.

Current Regulations: Section 685.206(c) provides that a borrower defense may be asserted 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 current regulations in §685.206(c) are described in more detail under "Borrower Responsibilities and Defenses (34 CFR 685.206)."

Subpart F of the Student Assistance General Provisions establishes the types of activities that may constitute substantial misrepresentation by an institution and defines "misrepresentation" and "substantial misrepresentation." "Misrepresentation" is defined in proposed §668.71(c) as a false, erroneous, or misleading statement that an eligible institution, one of its representatives, or any eligible institution, organization, or person with whom the eligible institution has an agreement to provide educational programs, or to provide marketing, advertising, recruiting, or admissions services, makes directly or indirectly to a student, prospective student, a member of the public, an accrediting agency, a State agency, or the Secretary. Under the proposed regulations, we would clarify that a misleading statement also includes any statement that has the likelihood or tendency to deceive. A statement is any communication made in writing, visually, orally, or through other means. "Misrepresentation" also includes the dissemination of a student endorsement or testimonial that a student gives either under duress or because the institution required the student to make such an endorsement or testimonial to participate in a program.

"Substantial misrepresentation," also defined in §668.71(c), means "any misrepresentation on which the person to whom it was made could reasonably be expected to rely, or has reasonably relied, to that person's detriment."

Proposed Regulations: Proposed §685.222(b), (c), and (d) would establish a new Federal standard for a borrower defense.

Proposed §685.222(b) would provide that if a borrower has submitted for consideration a nondefault, favorable contested judgment against the school based on State or Federal law from a court or administrative tribunal of competent jurisdiction for relief, the judgment might serve as a basis for a borrower defense. This would apply regardless of whether the judgment was obtained by the borrower as an individual or member of a class, or was obtained by a State attorney general (State AG) or other governmental agency. Judgments that could form the basis of a borrower defense under this section would not be limited to causes of action based on breach of contract or a substantial misrepresentation under §685.222(c) or (d), respectively. Rather, they could also be based on other causes of action under State or Federal law, provided that the claim relates to the making of the borrower's Direct Loan for enrollment at the school, or the provision of educational services for which the loan was provided.

There would be no time limitation on a borrower’s ability to assert a borrower defense based on such a judgment.

Proposed §685.222(c) would define the conditions under which a breach of contract might be the basis for a borrower defense and specify the limitation period for recovering payments previously made on the loan in connection with such a claim. Under proposed §685.222(c), a borrower would have a borrower defense if the school that the borrower received a Direct Loan to attend failed to perform its obligations under the terms of a contract with the student. A borrower would be permitted to assert, at any time, a claim based on breach of contract as a defense to repayment of the amount still outstanding on the loan. A borrower would be permitted to assert that same claim as grounds for recovery of amounts previously collected by the Secretary not later than six years after the breach by the school of its contract with the student.

Proposed §685.222(d) would establish the conditions under which a substantial misrepresentation might serve as the basis for a borrower defense, and the limitation period for recovering payments previously made on the loan. Under proposed §685.222(d), a borrower would have a borrower defense if the school or any of its representatives, or any institution, organization, or person with whom the school has an agreement to provide educational programs, or to provide marketing, advertising, recruiting, or admissions services, made a substantial misrepresentation that the borrower reasonably relied on when the borrower decided to attend, or to continue attending, the school. “Substantial misrepresentation” would have the definition set forth in subpart F, as amended by these proposed regulations. The proposed regulations would modify the definition of misrepresentation in §668.71(c) to replace the word “deceive” with “mislead under the circumstances.” The definition would also be expanded to specify that a misrepresentation includes any statement that omits information in such a way as to make the statement false, erroneous, or misleading.

Section 685.222(d) would also establish that a borrower may assert, at any time, a defense to repayment for amounts still owed on the loan to the Secretary, but may assert a right to recover funds previously collected by the Secretary no later than six years after the borrower discovers, or reasonably could have discovered, the information constituting the substantial misrepresentation.

The definition of “substantial misrepresentation” would require a borrower to have reasonably relied on a misrepresentation to his or her detriment. Under proposed

§685.222(d), in determining whether a borrower’s reliance on a misrepresentation was reasonable, the decision maker, whether a designated Department official or hearing official, as described in detail under “Process for Individual Borrowers (34 CFR 685.222(e)),” “Group Process for Borrower Defenses--General (34 CFR 685.222(f)),” “Group Process for Borrower Defenses--Closed School (34 CFR 685.222(g)),” and “Group Process for Borrower Defense Claims--Open School (34 CFR 685.222(h)),” could consider, among other things, if the school or its representatives or other specified parties engaged in conduct such as:

- Demanding that the borrower make enrollment or loan-related decisions immediately;
- Placing an unreasonable emphasis on unfavorable consequences of delay;
- Discouraging the borrower from consulting an adviser, a family member, or other resources;
- Failing to respond to the borrower’s requests for more information, including about the cost of the program and the nature of any financial aid; or
- Otherwise taking advantage of the borrower’s distress or lack of knowledge or sophistication.

Reasons: The current borrower defense standard in §685.206(c) is wholly dependent upon State law and, as a result, may provide uneven relief to students affected by the same bad practices but who attended schools in different States; a Federal standard would help to ensure fair and equitable treatment of all borrowers. Moreover, the reliance upon State law presents a significant burden for borrowers who are making a threshold determination as to whether they may have a claim and for Department officials who must determine the applicability and interpretation of laws that may vary from one State to another.

In crafting the Federal standard, the Department sought to incorporate not only the substantial misrepresentation regulation (34 CFR 668 subpart F), but also other causes of action upon which students had based complaints against schools in court cases. For example, the Federal standard maintains the borrower's ability to bring forward a claim based on a judgment determined by a court or administrative tribunal applying either State or Federal law. We also noted that a common claim that students had raised in lawsuits against postsecondary schools was breach of contract.[9] These bases for a borrower defense would ensure that the Federal standard provides effective relief opportunities for borrowers, and efficient administration of the process by which the Department and borrowers interpret and apply the standard, resulting in more timely resolution for all parties involved. However, we do not believe it would be appropriate to adopt a standard that would make the fact that the conduct violates an HEA requirement an automatic ground for a borrower defense, whether that claim is asserted directly or indirectly based on State law. Such conduct, to the extent it injures borrowers through substantial misrepresentation or a breach of contract, would already be covered by the proposed Federal standard. Moreover, it is not clear that any other such conduct forms an appropriate basis for loan discharge. Similarly, non-Federal negotiators suggested that the Department provide that all causes of action under State law constitute a basis for borrower defense. As explained previously, we believe that an approach based on State law would present a significant burden for borrowers and Department officials to determine the applicability and

[9] See, e.g., Vurimindi v. Fuqua Sch. of Bus., 435 F. App'x 129, 133 (3d Cir. 2011); Chenari v. George Washington Univ., No. CV 14-0929 (ABJ), 2016 WL 1170922 (D.D.C. Mar. 23, 2016).

interpretation of States' laws and would increase the risk of uneven relief for similarly situated borrowers; therefore, we decline to adopt such a standard.

Non-Federal negotiators also proposed other bases for borrower defense, such as deceptive, unfair, or abusive conduct. We carefully considered such suggestions and decided that they were not appropriate for the borrower defense regulations. The Department believes it would face significant challenges in determining which cases of such conduct warrant relief. A wide variety of conduct can be considered deceptive, unfair, or abusive, under both State and Federal law, and characterizing particular conduct as falling under such standards would require the Department to engage in a nuanced application of complex legal doctrines that vary across jurisdictions and that often have not been subject to a degree of judicial development sufficient to make their application to the borrower defense context clear. Furthermore, some of the significant sources of law regarding such conduct would not easily transfer to the borrower defense context. Federal and State law empowers government agencies to pursue relief for deceptive and unfair conduct.[10] In exercising this

[10] See, e.g., 12 U.S.C. 5531, 15 U.S.C. 43 (authorities used or referenced, respectively, by the Consumer Financial Protection Bureau

authority, Federal and State agencies are charged with gathering facts about particular practices, and weighing appropriate policy considerations to determine whether the practice warrants the exercise of their authority under these laws. The borrower defense regulations, on the other hand, are directed necessarily toward claims by individuals, which should not be subject to public policy considerations. Nonetheless, we agree with the negotiators that deceptive, unfair, or abusive practices that may not otherwise constitute a misrepresentation under the proposed definition should be taken into consideration when we are evaluating a borrower defense claim. See "Substantial misrepresentation: Reasonable reliance" in this section for a discussion of how we propose to consider such conduct for the purpose of a borrower defense claim based on a substantial misrepresentation.

The Department's substantial misrepresentation regulations (34 CFR part 668 subpart F) were informed by the FTC's policy guidelines on deception, and we believe they are more tailored to, and suitable for, use in the

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(CFPB) and State agencies, and the Federal Trade Commission (FTC)). For deceptive and unfair practices, the CFPB has stated that its standards are informed by the standards for the same terms as used by the FTC. See CFPB Bulletin 2013-7, "Prohibition of Unfair, Deceptive, or Abusive Acts or Practices in the Collection of Consumer Debts," (Jul. 10, 2013).

borrower defense context. The Department proposes that in the borrower defense context, certain factors addressing specific problematic conduct may be considered to determine whether a misrepresentation has been relied upon to a borrower's detriment, thus making the misrepresentation "substantial" under the proposed regulation. With regard to unfair and abusive conduct, we considered the available precedent and determined that it is unclear how such principles would apply in the borrower defense context as stand-alone standards. Such practices are often alleged in combination with misrepresentations and are not often addressed on their own by the courts. With this lack of guidance, it is unclear how such principles would apply in the borrower defense context. Moreover, many of the borrower defenses the Department has addressed or is considering have involved misrepresentations by schools, such as in the case of Corinthian. The Department believes that its proposed standard as described below will address much of the behavior arising in the borrower defense context. We believe that the standard that we are proposing appropriately addresses the Department's interests in accurately identifying and providing relief to borrowers for misconduct by schools; providing clear standards for borrowers, schools, and the Department to use in resolving claims; and avoiding for all parties the burden of interpreting other Federal agencies' and States' authorities in the borrower defense context.

As a result, the Department declines to adopt standards for relief based on unfair and abusive conduct. However, we note that actions against institutions may be taken, and borrowers may have avenues of relief outside of the Department, under other Federal or State statutes based on unfair and abusive conduct, which may result in State or Federal court judgments. Because the Department does not adopt the unfair and abusive conduct as a Federal borrower defense standards unless reduced to a contested judgment against the school under proposed §685.222(b), the Department does not consider its own findings and determinations in the borrower defense context for the proposed standards in §685.222 to be dispositive or controlling for actions brought by any other Federal or any State agency in the exercise of their power under the statutes on which they rely. We intend that, to the extent that borrowers fail to establish a claim under the regulations proposed here, such a determination does not affect the ability of another agency to obtain relief under a different standard that the agency is authorized to apply.

We note that the Department commonly uses the term "hearing official" in its regulations, such as 34 CFR subparts G and H (proceedings for limitation, suspension, termination and fines, and appeal procedures for audit determinations and program review determinations). The hearing officials referred to in the proposed regulations would make decisions and determinations independent of the Department official described in proposed §685.222(e) to (h). Although here we use the term "Department official" to describe the individual who reviews and decides an individual borrower defense claim pursuant to §685.222(e), for the group processes described in proposed §685.222(g) and (h), we use the term "Department official" to describe the individual who performs a very different role. In the group process, the "Department official" is the individual who would initiate the group borrower defense process and who would present evidence and respond to any argument for the group borrower defense claimants. The decision would then be made by the hearing official, who is independent of the Department official who asserts the claims, and that decision would be based on the merits of the borrower defense claim as described in the proposed regulations, and not upon other considerations.

<u>Judgment against a school</u>

As discussed, the Department is declining to adopt a standard based on applicable State law for loans first disbursed after July 1, 2017, due, in part, to the burden to borrowers and Department officials in interpreting and applying States' laws. While we believe that the proposed standards will capture much of the behavior that can and should be recognized as the basis for borrower defenses, it is possible that some State laws may offer borrowers important protections that do not fall within the scope of the Department's Federal standard. To account for the situations in which this is the case, the proposed regulations would provide, as a basis for a borrower defense, nondefault, contested judgments obtained against a school based on any State or Federal law, whether obtained in a court or administrative tribunal of competent jurisdiction. Under the proposed regulations, a borrower may use such a judgment as the basis for a borrower defense if the borrower was personally affected by the judgment, that is, the borrower was a party to the case in which the judgment was entered, either individually or as a member of a class that obtained the judgment in a class action lawsuit. As with all the borrower defense standards, to support a borrower defense claim, the judgment would be required to pertain to the making of a Direct Loan or the provision of educational services to the borrower. We believe that the proposed standard would allow for recognition of State law and other Federal law causes of action, but would also reduce the burden on the Department and borrowers of having to make determinations on the applicability and interpretation of those laws.

We also propose that a judgment obtained by a governmental agency, such as a State AG or a Federal agency, that a borrower can show relates to the making of the borrower's Direct Loan or the provision of educational services to the borrower, may also serve as a basis for a borrower defense under the standard, whether the judgment is obtained in court or in an administrative tribunal. Governmental agencies may not specifically join individual constituents as parties to a lawsuit; however, any resulting judgment may result in determinations that an act or omission of a school was in violation of State or Federal law and thus be the basis of a borrower defense for an individual within the group identified as injured by the conduct for which the government agency brought suit.

In considering a borrower defense claim, for either an individual borrower under proposed §685.222(e) for individually-filed applications or for a group of borrowers under proposed §685.222(f),(g), and (h), based upon a favorable judgment obtained in court or an administrative tribunal, the Department will consider the relief to which that judgment entitles the borrower based upon the judgment's findings regarding the school's liability under the state or Federal law at issue, whether or not the form and amount of relief was prescribed as part of the favorable judgment. Depending on the facts and circumstances of the judgment, the Department may determine relief as described in proposed §685.222(i).[11] The Department will also consider to what degree the claimant has already received relief as an outcome of the judgment at issue, if any.

The Department is aware that many court cases may not result in contested, nondefault judgments, for reasons such as settlement. However, we are proposing to limit the basis for a borrower defense under §685.222(b) to nondefault, contested judgments in courts or administrative tribunals. The Department is seeking to establish a process that results in accurate determinations of borrower defenses after a careful consideration of evidence. We are

[11] For example, the judgment may be one obtained by an enforcement agency and may not identify or require any individual as a party for whom particular relief is required; the judgment may simply provide injunctive relief, barring a particular practice as violating applicable law, but not addressing or requiring any relief for individuals; or the judgment may find liability, but also determine that the affirmative claim is time-barred.

proposing to consider decisions made by courts and administrative tribunals, as the decision-making process in those forums similarly involves a consideration of evidence from all parties and the decision is one that has been made on the merits of the claim. By limiting this standard to nondefault, contested judgments, we would reduce or eliminate the need for the Department to evaluate the merit of borrower claims based on State law by including only those judgments that are in fact the product of litigation in which both claimant and school challenged the contentions of the opponent and a tribunal decided the case on the merits. The standard would echo the principle of res judicata, whereby parties are bound by a judgment entered by a court of competent jurisdiction and may not challenge that judgment either before that tribunal or before a different tribunal. Default judgments generally do not involve the same level of factual and evidentiary evaluation, or provide a decision on the merits resulting from a contested hearing where all parties have had an opportunity to present evidence and arguments. Similarly, settlements do not require a decision maker to reach a decision after an evaluation of the evidence. As a result, we propose that judgments may form the basis of a borrower defense only if they are nondefault, contested judgments rendered by a court or administrative tribunal of competent jurisdiction.

Although other court orders that do not rise to the level of a contested, nondefault judgment (e.g., settlement or motion to dismiss orders) may not be used to satisfy the proposed judgment standard for borrower defense claims, the Department welcomes the submission of and will consider any such orders, other court filings, admissions of fact or liability, or other evidence used in such a court proceeding as evidence in the borrower defense process under the other proposed standards. The Department would also welcome the submission of and will consider any arbitration filings, orders, and decisions for consideration in the borrower defense process. Similarly, we recognize that a party to a suit or administrative proceeding may be barred from disputing a factual finding or issue decided in that proceeding if that fact or issue were to arise in a different case, even if the ruling on the fact or issue was not a final judgment on the merits resulting from a contested proceeding that meets the standard we propose here. We propose to take such findings and rulings on such specific facts and issues into account, and give them appropriate weight if principles of collateral estoppel would bar the school from disputing the matter.

Breach of contract

In developing a new Federal borrower defense standard, we recognize that students enter into enrollment agreements and other contracts with the school to provide educational services and that borrowers have, over the years, asserted claims for relief against schools for losses arising from a breach of those contracts.[12] We therefore propose to include a separate ground for relief, based on a breach by the school of the contract with the borrower, because such claims may not necessarily fall within the scope of the substantial misrepresentation component of the Federal standard.

The terms of a contract between the school and a borrower will largely depend on the circumstances of each claim. For example, a contract between the school and a borrower may include an enrollment agreement and any school catalogs, bulletins, circulars, student handbooks, or school regulations.[13]

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[12] See, e.g., Vurimindi v. Fuqua Sch. of Bus., 435 F. App'x 129 (3d Cir. 2011).

[13] In Ross v. Creighton University, 957 F.2d 410 (7th Cir. 1992), in describing the limits of a contract action brought by a student against a school, the court stated that there is "'no dissent'" from the proposition that "'catalogues, bulletins, circulars, and

A non-Federal negotiator requested that we limit the standard to material breaches of contract.[14] The Department anticipates that it may receive borrower defense claims regarding breaches of contract that may not be considered to be material breaches that would have warranted a cancellation of the contract between the borrower and the school. For example, a breach of contract may pertain to a school's failure to fulfill a specific contractual promise to provide certain training or courses, but the school may have otherwise performed its other obligations under its contract with the borrower. The Department is comfortable with its ability to grant relief commensurate to the injury to a borrower alleged under the breach of contract standard, which may constitute full relief or partial relief with respect to a borrower's Direct Loan. The Department's proposed methods for determining relief, which would require a consideration of available evidence and arguments by a Department official or a hearing official, as applicable, are discussed in more detail under "Borrower Relief (34 CFR 685.222(i) and Appendix A)."

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regulations of the institution made available to the matriculant'" become part of the contract. See 957 F.2d at 416 (citations omitted). See also Vurimindi, 435 F. App'x at 133 (quoting Ross).

[14] See Modern Law of Contracts § 11:1 (quoting Andersen, A New Look at Material Breach in the Law of Contracts, 21 UC Davis L. Rev. 1073 (1988)) ("[M]ateriality is best understood in terms of the specific purpose of the cancellation remedy that material breach entails.")

The non-Federal negotiator also requested that we exclude claims for educational malpractice or claims regarding schools’ academic standards. As explained earlier in this discussion, we decline to impose a materiality requirement, but would consider the circumstances underlying a breach of contract borrower defense and award relief that is commensurate with the injury to the borrower. We also explain under “Borrower Defenses--General (§685.222(a))”))” that the Department does not consider claims relating to educational malpractice or academic disputes to be within the scope of the proposed borrower defense regulations.

Substantial misrepresentation

The proposed Federal standard for borrower defense based upon a substantial misrepresentation is predicated on existing regulations in the Student Assistance General Provisions (34 CFR 668 subpart F) that address misrepresentation. These existing regulations provide a clear framework regarding the acts or omissions that would constitute misrepresentations as they relate to the nature of educational programs, the nature of financial charges, and the employability of graduates.

Under proposed §685.222(d), to establish a borrower defense based on a substantial misrepresentation, a borrower must demonstrate that (1) there was a misrepresentation by the college made to the borrower, (2) the borrower reasonably relied on that substantial misrepresentation when he or she decided to attend, or to continue attending, the school, and (3) that reliance resulted in a detriment to the borrower.

Substantial misrepresentation: Misrepresentation

We have proposed to revise the definition of "misrepresentation" in §668.71 to provide clarity and specificity, as it is important that the definition of "misrepresentation," whether for the Department's enforcement purposes or in the borrower defense context, capture the full scope of acts and omissions that may result in a borrower being misled about the provision of educational services or making of a Direct Loan.

Specifically, we propose to replace the word "deceive" with "mislead under the circumstances." In some contexts the word "deceive" implies knowledge or intent on the part of the school, which is not a required element in a case of misrepresentation. Although we stated that the Department "considers a variety of factors, including whether the misrepresentation was intentional or inadvertent" in the preamble to the final rule for subpart F, 75 FR 66915, we believe that this proposed change would more clearly reflect the Department’s intent that a misrepresentation does not require knowledge or intent on the part of the school. A non-Federal negotiator at the negotiated rulemaking requested that specific intent be considered as an element of misrepresentation. As the Department explained in the preamble to the final rule for subpart F, 75 FR 66914, while the Department declines to include a specific intent element, the Department has always operated within a rule of reasonableness and has not pursued sanctions without evaluating the available evidence in extenuation and mitigation as well as in aggravation. Whether using the definitions in subpart F for the Department’s enforcement purposes or for evaluating a borrower defense claim, we intend to continue to consider the circumstances surrounding any misrepresentation before determining an appropriate response. That said, the general rule is that an institution is responsible for the harm to borrowers caused by its misrepresentations, even if such misrepresentations cannot be attributed to institutional intent. We believe this is more reasonable and fair than having the borrower (or the Department) bear the cost of such injuries. It is also reflective of the consumer protection laws of many States.

We also propose to add to the definition of "misrepresentation" a sentence addressing omissions, which would read, "Misrepresentation includes any statement that omits information in such a way as to make the statement false, erroneous, or misleading." Some non-Federal negotiators were concerned about the use of the word "information" as opposed to "facts." These non-Federal negotiators were concerned that the use of the word "facts" might imply a higher standard than would be required for a borrower to prove a substantial misrepresentation had occurred. Another non-Federal negotiator believed that a misrepresentation of "facts" more accurately described what should be required. Although we believe that the two words are effectively synonymous, we propose to use the word "information," as this change was endorsed by most of the non-Federal negotiators.

Non-Federal negotiators requested that the Department clarify what is meant by "misleading under the circumstances," as used in the proposed definition of "misrepresentation." One non-Federal negotiator asked whether the term "under the circumstances" was a reference to the use of the term by the Federal Trade Commission (FTC). In the 1983 FTC Policy Statement on Deception, the FTC clarified that, for a representation, omission, or practice to be deceptive, it must be likely to mislead reasonable consumers under the circumstances.[15] The FTC looks at the totality of the practice when determining how a reasonable recipient of the information would respond. If a representation is targeted to a specific audience, then the FTC determines the effect of the practice on a reasonable member of that group. We believe it is appropriate that, in reviewing a borrower defense claim based on a substantial misrepresentation, we similarly consider the totality of circumstances in which the statement or omission occurs, including the specific group at which a statement or omission was targeted, to determine whether the statement or omission was misleading under the circumstances. A statement made to a certain target group of students may not lead to reliance and injury; however, when the statement is made to a different target group that may not be the case.

Moreover, we propose to include the language "under the circumstances" to clarify that, to constitute a substantial misrepresentation, the misleading statement or omission must have been made in a situation where the borrower or student should have been able to rely upon the

[15] FTC Policy Statement on Deception, 103 F.T.C. 110, 174 (1984) (appended to Cliffdale Assocs., Inc., 103 F.T.C. 110 (1984)), available at www.ftc.gov/bcp/policystmt/ad-decept.htm.

school to provide accurate information. For example, if a student is speaking with a course instructor about her difficulties paying tuition and the course instructor advises her to meet with the financial aid office because "there are scholarships available," that circumstance would most likely not create an expectation that the course instructor is assuring the student that she will receive a scholarship. However, if a student is speaking with a financial aid advisor and asks if she will receive scholarships to help cover the cost of her education and the financial aid advisor says, "Yes. Most of our students receive scholarships," that statement may be considered misleading under the circumstances, given that the speaker is someone whose professional role is to provide students with guidance pertaining to student aid.

Substantial misrepresentation: Reasonable reliance

Although the definition of "substantial misrepresentation" in §668.71 requires that the borrower reasonably relied on the misrepresentation, or could reasonably be expected to rely, proposed §685.222(d) would require there to have been actual reasonable reliance. Section 668.71 refers to the Department's enforcement authority to impose fines, or limit, suspend, or terminate a school's participation in title IV, HEA programs. As an enforcement body acting in the public interest, the Department believes that it is appropriate for the Department to be able to stop misrepresentations even before any persons are misled, and thus to act upon misrepresentations that "could have been reasonably relied upon" by a person. However, borrower defenses relate to injuries to individual borrowers. Unlike the Department's interest in public enforcement of its regulations and laws, an individual borrower's interest in bringing a borrower defense is predicated upon the harm to the borrower. We also believe that an actual reliance requirement will protect the Federal Government, taxpayers, and institutions from unsubstantiated claims. As a result, we believe that it is appropriate to require that the evidence show that the misrepresentation at issue influenced the borrower, or led to the borrower's reliance on the misrepresentation, to the borrower's detriment. We note, however, that a rebuttable presumption of reasonable reliance may arise in claims brought for a group of borrowers, as we discuss in detail under "Group Process for Borrower Defenses--General (34 CFR 685.222(f))."

Generally, reasonable reliance refers to what a prudent person would believe and act upon if told something by another person. Moreover, reasonable reliance considers the representation or statement from the viewpoint of the audience the message is intended to reach--in this case, prospective or continuing students. Thus, in assessing whether a substantial misrepresentation has occurred, the Department would consider the facts of the case in the context of the audience.

As discussed, the standard requires not just that a borrower has relied upon a misrepresentation to the borrower's detriment, but also requires that the reliance be reasonable. As discussed in the introduction to this "Reasons" section, non-Federal negotiators representing students and borrowers, consumer advocacy organizations, and legal assistance organizations that represent students and borrowers, advocated that the Federal standard include a provision for abusive practices on the part of a school, particularly as they relate to high pressure or aggressive sales tactics. We agree that there has been evidence of such conduct on the part of some schools, but believe it would be difficult to develop clear, consistent standards as to when such conduct, in the absence of any misrepresentation by the school, should give rise to a right of relief from the loans taken out to attend the school. However, we also believe that such high pressure or aggressive sales tactics may make borrowers more likely to rely upon a misrepresentation. As a result, we have determined that reliance on a misrepresentation may be appropriately viewed as more reasonable when the misrepresentation is made in the context of certain circumstances, including those that may be considered to be high pressure or aggressive sales tactics.

To address these concerns, in proposed §685.222(d) we include a non-exhaustive list of examples of factors that, if present in conjunction with a misrepresentation on the part of the school, would likely elevate that misrepresentation to a substantial misrepresentation. However, as proposed by the Department, the factors by themselves would not necessarily mandate a finding of substantial misrepresentation, nor would the absence of any of the factors defeat a borrower defense based on substantial misrepresentation. It may be entirely reasonable for a borrower to rely on a misrepresentation without any of these factors present. Rather, as proposed, the factors would be non-exhaustive examples of conduct that could be considered in a determination of whether a borrower's reliance on a misrepresentation was reasonable, even if such reliance would not have been reasonable in the absence of such conduct, thus making the misrepresentation substantial.

Specifically, we looked at the borrower defenses before the Department and comments from non-Federal negotiators regarding issues such as schools making insistent demands of students to make commitments to enroll and the borrowers' lack of information and resources. As a result, we propose that a misrepresentation, when coupled with conduct that affects a borrower's understanding of his or her decision-making timeframe, such as demanding that the borrower make enrollment or loan-related decisions immediately or placing an unreasonable emphasis on unfavorable consequences of delay, may lead a borrower to reasonably rely upon the misrepresentation and, thus, elevate the misrepresentation to a substantial misrepresentation for the purposes of asserting a borrower defense. Similarly, conduct that affects a borrower's information-gathering regarding the risks and potential benefits of his or her decision, such as discouraging a borrower from consulting an advisor, a family member, or other resources or failing to respond to a borrower's reasonable requests for information, may lead a borrower to reasonably rely upon the misrepresentation for the purposes of asserting a substantial misrepresentation as a borrower defense. We also recognize that school conduct that takes advantage of the borrower's distress or lack of knowledge or sophistication may also elevate the misrepresentation to a substantial misrepresentation, by way of affecting a borrower's reasonable reliance on a misrepresentation, for the purposes of borrower defense. For example, a school may be found to have made statements that would not have been misleading to a borrower of average English ability; however, when made to a borrower with limited English proficiency in a way that takes advantage of the borrower's lack of knowledge or sophistication, the circumstances may warrant a borrower defense under the standard.

As noted above, a non-Federal negotiator requested that the Department use a "justifiable" reliance standard. While a reasonable reliance standard looks to whether a reasonably prudent person would be justified in his or her reliance and may be measured against the behavior of other persons, the justifiable reliance standard is measured by reference to the plaintiff's capabilities and knowledge.[16] As discussed, the proposed standard would allow consideration of practices that would impact a specific

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[16] See Restatement (Third) of Torts: Liab. for Econ. Harm § 11 TD No 2 (2014)("[R]easonableness is measured against community standards of behavior. Justifiable reliance has a personalized character. It is measured by reference to the plaintiff's capabilities and knowledge; a plaintiff's sophistication may affect a court's judgments about what dangers were fairly considered obvious.").

borrower’s understanding and reliance upon a misrepresentation in a way that would reference the borrower’s understanding and knowledge. However, the Department believes that it is appropriate for the proposed standard to consider the perspective of not only the borrower, but of similarly situated borrowers, especially to the extent it is composed of other Direct Loan borrowers or potential Direct Loan borrowers who may be subject to the same misrepresentations by the school. As discussed under “Group Process for Borrower Defenses--General (34 CFR 685.222(f)),” “Group Process for Borrower Defenses--Closed School (34 CFR 685.222(g)),” and “Group Process for Borrower Defense Claims--Open School (34 CFR 685.222(h)),” in addition to proposing this regulation to provide relief for individual borrowers who have filed applications for relief, the borrower defense regulation also proposes that the Department may initiate a process for determinations as to both a school’s liability and as to borrower defenses for a group of borrowers, which may include those who have not applied for relief. As discussed under “Group Process for Borrower Defenses--General (34 CFR 685.222(f)),” the Department anticipates that such proceedings, in which Secretary may recover from the school the amount of losses from granting borrower defense relief, will have a significant deterrent effect on the school and promote compliance among other schools in a way that will benefit other borrowers. By considering both the individual borrower's perspective and the perspective of similarly situated borrowers at the institution, we believe the Department official or hearing official, as applicable, would be able to determine an amount of relief that is fair to the borrower and protect the Department's general interest in other Direct Loan borrowers who have also attended the school and who may have been subject to the same misrepresentations.

The non-Federal negotiator also requested that we limit the standard to material misrepresentations. It is the Department's understanding that under Federal deceptive conduct prohibitions, a misrepresentation must be material for deception to occur. In this context, material misrepresentation involves information important to consumers, likely to affect the consumer's choice or conduct regarding a product or service.[17] The Department

[17] See, e.g., F.T.C. Policy Statement on Deception, 103 F.T.C. at 182; see also Restatement (Second) of Torts § 538 (1977) ("The matter is material if (a) a reasonable man would attach importance to its existence or nonexistence in determining his choice of action in the transaction in question; or (b) the maker of the representation knows or has reason to know that its recipient regards or is likely to regard the matter as important in determining his choice of action, although a reasonable man would not so regard it.").

believes that a materiality element is not required in either the proposed amendments to the definition for the Department's enforcement authority under §668.71 or as this definition is adopted for the purposes of the proposed Federal standard under §685.222(d). In the context of the Department's enforcement authority, the Department previously declined in 2010 to adopt a materiality component, stating that the regulatory definition of "substantial misrepresentation" is "clear and can be easily used to evaluate alleged violations of the regulations." 75 FR 66916.

In adopting the definition of "substantial misrepresentation" for the purposes of borrower defense, the Department similarly believes that the definition is clear and can be easily used to evaluate borrower defenses. Moreover, a substantial misrepresentation in the borrower defense context incorporates similar concepts to materiality. Under proposed §685.222(d), the borrower must show that he or she "reasonably relied" upon the misrepresentation at issue. As discussed above, generally materiality refers to whether the information in question was information to which a reasonable person would attach importance to, in making the decision at issue. Similarly, in determining whether the borrower reasonably relied on the misrepresentation, the Department would consider whether the misrepresentation related to information to which the borrower would reasonably attach importance in making the decision to enroll or continue enrollment at the school. As a result, the Department considers it unnecessary to add an explicit materiality element to the definition of "substantial misrepresentation," for the purposes of claims under the borrower defense regulations.

Substantial misrepresentation: The borrower's detriment

The definition of "substantial misrepresentation," for the purpose of proposed §685.222(d), would require that the borrower reasonably relied on the misrepresentation to the borrower's detriment. As noted previously, the proposed borrower defense regulations are intended to provide relief for individual borrowers for schools' wrongful conduct that led in a meaningful way to harm or injury to the borrower based upon the borrower's specific circumstances. We believe that a demonstration of detriment or injury to the borrower will protect the Federal government, taxpayers, and institutions from unsubstantiated claims. As a result, we believe that it is appropriate to require that a preponderance of the evidence demonstrate the misrepresentation at issue influenced the borrower, or led to the borrower’s reliance on the misrepresentation, to the borrower’s detriment.

Limitation periods

For each of the bases for a borrower defense under the proposed Federal standard, the Department considered whether there should be a limitation on the time period during which borrower defense claims may be brought and, if so, what the limitation period should be. Because the availability of evidence for a borrower defense that is based on a judgment in a court or administrative tribunal is not a concern, as the only evidence required is the judgment itself, we propose no limitation period under proposed §685.222(b) for those claims. However, for the bases for a borrower defense in proposed §685.222(c) and (d), we believe a limitation period is appropriate. A limitation period for borrower defense claims based on a breach of contract or substantial misrepresentation, by encouraging borrowers to assert borrower defense claims while memories and evidence are fresh, would make the claim resolution process more reliable.

When considering a limitation period that would provide for a reasonable amount of time during which a borrower might submit a claim, we also recognized that common law generally allows a debtor to assert claims from the same transaction as the loan at any time as a defense to repayment of the loan, but requires a debtor to assert any claim for recovery of payments already made within the deadlines that would apply had the debtor brought suit on the claim. Consistent with that generally applicable principle, we propose here that no limitation period would apply to borrower defense claims asserted under proposed §685.222(c) or (d) as defenses to repayment of any outstanding loan obligation. To select an appropriate limit on the period during which a claim for recovery may be made, we looked to the existing limitation periods under State and Federal law for similar claims. With regard to a borrower defense claim based on a substantial misrepresentation, we considered, among other things, limitation periods applicable to consumer protection and fraud claims, as those claims often address misleading or deceptive conduct and are, thus, analogous to claims based on a substantial misrepresentation.

The Department's research indicates that six years is one of the breach of contract limitation periods most commonly used by States, as well as the limitation period applicable to non-tort claims against the United States, 28 U.S.C. 2401(a).

Because many non-Federal negotiators' discussions of school misconduct included discussions of fraud, the Department also considered existing limitation periods for fraud. Although limitation periods under State consumer protection laws vary, our research indicates that three years is one of the most common limitation periods used by the States.

For claims for recovery of payments already made that are based on breach of contract, we propose a six-year limitation period that would begin upon the breach of contract. For claims for recovery of payments already made that are based on a substantial misrepresentation, we also propose six years as the limitation period, but the period would begin when a borrower discovers or should have reasonably discovered the facts that constitute the misrepresentation. Although six years is longer than the period afforded under many State laws for fraud and consumer protection, other States do provide a six-year limitation period for similar claims, and the Department believes a six-year period would provide sufficient time for a borrower to gather evidence related to a substantial misrepresentation.

The non-Federal negotiators representing consumer advocates, legal assistance organizations, and State AGs suggested that no limitation period should apply to defenses to repayment of remaining amounts owed on a debt, under the legal principle of recoupment (asserting a claim as a defense to repayment). As noted earlier, we propose to adopt this position. Later, some non-Federal negotiators suggested that, notwithstanding the distinction under State and Federal law between recoupment and asserting a claim for an affirmative recovery of amounts previously paid, the Department should apply no limitation period to affirmative claims for recovery. In support of this position, they cited the Department's ability to collect on a Direct Loan until it is paid in full or discharged. Other non-Federal negotiators, however, expressed concerns about having no limitation period for borrower defense claims, stating that such an approach would result in significant difficulties for a school in responding to allegations due to a lack of documentary evidence and witnesses and would subject schools to broader liability than under the current borrower defense standard based upon State law under §685.206(c).

After careful consideration of the legal principles cited by the negotiators, we do not believe there is justification to depart from the requirements that Federal and State courts generally apply to affirmative claims to recover amounts already collected on a debt. We believe the proposed limitation periods are appropriate for the reasons stated above, regarding existing periods of limitation in State and Federal law and the Department's interest in the reliability of the claim resolution process. However, we seek comment on whether the Department should adopt different limitation periods for borrower defense claims under §685.222(c) and (d), and, if so, what the limitation periods should be, what the supporting rationale for those periods would be, and why those other limitation periods would meet the objectives outlined in this section.

Non-Federal negotiators asked the Department to clarify, with respect to the substantial misrepresentation limitation period, when a borrower would be deemed to have discovered, or when a borrower should have reasonably discovered, the facts constituting a substantial misrepresentation. For example, a borrower may learn of a substantial misrepresentation upon discussion with other students or borrowers, or it may be deemed that a borrower should have reasonably known of the facts underlying a substantial misrepresentation if facts concerning the misrepresentation are published in nationwide news articles. However, the borrower must demonstrate when the borrower discovered the facts underlying the specific substantial misrepresentation forming the basis of the borrower defense. For example, knowledge of one particular problem at a school would not necessarily give notice of other, unrelated problems. Thus, student warnings issued for gainful employment programs under 34 CFR 668.410 or relating to repayment rate under proposed §668.41(h), or the disclosure of proposed financial protections, such as a letter of credit, under proposed §668.41(i), would warn students about whether a program could close soon, the repayment outcomes of borrowers at the school, or the school's financial risk, but would not put students on notice of misrepresentations by the school of matters other than earnings and debt of graduates or financial soundness.

To demonstrate that the borrower is asserting a borrower defense within six years of discovery of the facts on which the claim is based, the borrower should explain in the borrower defense application how he or she learned of the substantial misrepresentation and include any applicable documents or other information demonstrating the source of the knowledge. Again, we note that, under the proposed regulations, the borrower may assert a claim based on substantial misrepresentation solely for discharge of the remaining amount owed on the Direct Loan at any time.

Process for individual borrowers (§685.222(e))

Statute: Section 455 of the HEA sets forth the terms and conditions of Direct Loan Program loans.

Current Regulations: Section 685.206(c) states that borrowers have the right to assert borrower defenses, but does not establish any process for doing so.

Proposed Regulations: Proposed §685.222(e) would establish the process for an individual borrower to bring a borrower defense. Proposed §685.222(e)(1) would describe the steps an individual borrower must take to initiate a borrower defense claim. First, an individual borrower would submit an application to the Secretary, on a form approved by the Secretary. In the application, the borrower would certify that he or she received the proceeds of a loan to attend a school; would have the opportunity to provide evidence that supports the borrower defense; and would indicate whether he or she has made a claim with respect to the information underlying the borrower defense with any third party, and, if so, the amount of any payment received by the borrower or credited to the borrower's loan obligation. The borrower would also be required to provide any other information or supporting documentation reasonably requested by the Secretary. The Secretary would provide notice of the borrower’s application for a borrower defense to the school at issue.

Proposed §685.222(e)(2) would describe the treatment of defaulted and nondefaulted borrowers upon the Secretary’s receipt of the borrower defense claim. If the borrower is not in default on the loan for which a borrower defense has been asserted, the Secretary would grant an administrative forbearance, notify the borrower of the option to decline the forbearance and to continue making payments on the loan, and provide the borrower with information about the availability of the income-contingent repayment plans under §685.209 and the income-based repayment plan under §685.221. If the borrower is in default on the loan for which a borrower defense has been asserted, the Secretary would suspend collection activity on the loan until the Secretary issues a decision on the borrower’s claim; notify the borrower of the suspension of collection activity and explain that collection activity will resume if the Secretary determines that the borrower does not qualify for a full discharge; and notify the borrower of the option to continue making payments under a rehabilitation agreement or other repayment agreement on the defaulted loan.

To process the claim, the Secretary would designate a Department official to review the borrower’s application to determine whether the application states a basis for a borrower defense, and would resolve the claim through a fact-finding process conducted by the Department official. As part of the fact-finding process, the Department official would consider any evidence or argument presented by the borrower and would also consider any additional information, including Department records, any response or submissions from the school, and any additional information or argument that may be obtained by the Department official. The Department official would identify to the borrower, and may identify to the school, the records he or she considers relevant to the borrower defense. The Secretary provides any of the identified records upon reasonable request to either the school or the borrower.

At the conclusion of the proposed fact-finding process, the Department official would issue a written decision. The decision of the Department official would be final as to the merits of the claim and any relief that may be warranted on the claim. If the Department official approves the borrower defense, the Department official would notify the borrower in writing of that determination and of the relief provided as determined under §685.222(i) or, if the Department official denies the borrower defense in full or in part, the Department official would notify the borrower of the reasons for the denial, the evidence that was relied upon, the portion of the loan that is due and payable to the Secretary, whether the Secretary will reimburse any amounts previously collected, and would inform the borrower that if any balance remains on the loan, the loan will return to its status prior to the borrower's application. The Secretary would also inform the borrower of the opportunity to request reconsideration of the claim based on new evidence not previously provided or identified as relied upon in the final decision.

Under proposed §685.222(e)(5)(ii), the Secretary could reopen a borrower defense application at any time to consider evidence that was not considered in making the previous decision. The Secretary could also consolidate individual applications that have common facts and claims and resolve such borrower defenses as a group through the group processes described under "Group Process for Borrower Defenses--General (34 CFR 685.222(f))," "Group Process for Borrower Defenses--Closed School (34 CFR 685.222(g))," and "Group Process for Borrower Defense Claims--Open School (34 CFR 685.222(h))."

Finally, the Secretary could initiate a separate proceeding to collect from the school the amount of relief resulting from a borrower defense.

Reasons: The current regulations for borrower defense do not provide a process for claims. Since Corinthian's 2015 bankruptcy, the Department has received a number of borrower defense claims from individuals outside of the Federal loan relief process initiated by the Department for Corinthian students in response to the bankruptcy. The lack of guidance has led to confusion for borrowers and inconsistency in the types and format of information submitted for such requests. To ease the Department's administrative burden in reviewing such requests and the burden of borrowers making borrower defense claims, we propose §685.222(e) to establish clear guidelines for individuals who wish to submit a borrower defense claim.

Many of the non-Federal negotiators at the negotiated rulemaking sessions emphasized the advantages of deciding claims on a group basis wherever possible. In response to these arguments, the proposed regulations would permit the Secretary to consolidate individual claims that present common facts and claims pertaining to the same school and resolve those claims through the group processes described under "Group Process for Borrower Defenses--General (34 CFR

685.222(f)),” “Group Process for Borrower Defenses--Closed School (34 CFR 685.222(g)),” and “Group Process for Borrower Defense Claims--Open School (34 CFR 685.222(h)).”

To standardize the form of the requests and facilitate the Department’s efficient review, under the proposed process, the Department would create an easy-to-use claim form for borrower defense for use by individual borrowers to provide information regarding the borrower’s Direct Loan and evidence the borrower may have in support of his or her claim, or such other information that the Department may reasonably decide is necessary. In addition, the application would require the borrower to indicate if he or she has submitted a claim to, and received money from, entities aside from the Department for the same alleged harm underlying the borrower defense claim. We believe requesting such information is important to make clear to borrowers the information the Department needs from them, to ensure the fairness of the discharge process, and to protect Federal taxpayers by prohibiting borrowers from collecting relief from multiple parties for the same claim. If the borrower should choose to be represented by counsel, the Department would work directly with such a representative, upon receipt of the borrower’s consent.

One non-Federal negotiator requested that the Department clarify what evidence might be considered by the Department official, or hearing official, in the group processes discussed under "Group Process for Borrower Defenses--General (34 CFR 685.222(f))," "Group Process for Borrower Defenses--Closed School (34 CFR 685.222(g))," and "Group Process for Borrower Defense Claims--Open School (34 CFR 685.222(h))," when adjudicating a claim for borrower defense. Evidence that a borrower could submit as part of the application may include, but would not be limited to: the borrower's own statement or declaration regarding the claim, statements of any other persons that the borrower believes support the claim, and copies of any documents that may be relevant to the borrower's claim. These documents may include, for example, copies of the enrollment agreement with the school, school catalogs, bulletins, letters or other communications, Web page print-outs, circulars, advertisements, or news articles. In addition to written materials, documents may also include any media by which information can be preserved, such as videos or recordings. For applications filed by an individual, a Department official may also contact the borrower to obtain more information and such oral statements may also be evidence that would be considered in the borrower defense process. The Department official may also consider other information that the Department has in its possession, such as information obtained from the school or otherwise obtained by the Department or third parties (e.g., accreditors, government agencies). The kind of evidence that will be needed and available to determine the validity of the borrower's claim will vary from case to case and will depend on the specific circumstances of each borrower's claim.

The Department also proposes in §685.222(e)(7) that the Secretary may initiate a separate proceeding to collect from the school the amount of relief resulting from a borrower defense determined under §685.222(e). As proposed, the Secretary may initiate a proceeding to recover against the school, but may also determine that a separate proceeding will not be initiated. For example, the Secretary may decide not to initiate such a proceeding due to evidentiary constraints. The Department intends that the proposed fact-finding process used for an individual borrower defense claim would be separate and distinct from the Department's efforts to recover from schools any losses arising from a borrower defense. The final decision would determine the amount of relief to be awarded, which in turn would determine the amount of losses to the Secretary that the Department can then collect from the school. However, the Department's proposed regulation would not condition borrower relief awarded in this proceeding on whether the Secretary has the actual ability to recover those losses from the school. Rather, the Department will provide relief to the borrower according to the final decision of this process, and the Department's action to recover losses from the school will follow in a separate proceeding.

Group Process for Borrower Defenses--General (§685.222(f))

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.

Section 487 of the HEA provides that institutions participating in the title IV, HEA programs shall not engage in substantial misrepresentation of the nature of the institution's education program, its financial charges, or the employability of its graduates.

Current Regulations: Section 685.206(c) states that borrowers have the right to assert borrower defenses, but does not establish any process for doing so.

Proposed Regulations: Proposed §685.222(f) would provide a framework for the borrower defense group process, including descriptions of the circumstances under which borrower defense claims asserted by or with regard to a group could be considered and the process the Department would follow for borrower defenses for a group.

Generally, we propose that the Secretary would initiate a review of borrower defense claims asserted by or with regard to a group. This would occur when, upon consideration of factors including, but not limited to, the existence of common facts and claims among borrowers that are known to the Secretary, fiscal impact, and the promotion of compliance by the school or other title IV, HEA program participants, the Secretary determines it is appropriate to initiate a process to determine whether a group of borrowers has a common borrower defense.

The proposed regulations would also provide for members of the group to be identified by the Secretary from individually filed applications or from any other source of information. Moreover, if the Secretary determines that common facts and claims exist that apply to borrowers who have not filed an application, the Secretary could include such borrowers in the group.

Once a group of borrowers with common facts and claims has been identified, under §685.222(f)(2)(i), the Secretary would designate a Department official to present the group's common borrower defense claim in the fact-finding process described in §685.222(g) or (h) of this section, as applicable, and would provide each identified member of the group with notice that allows the borrower to opt out of the proceeding. The Secretary would notify the school, as practicable, of the basis of the group's borrower defense, the initiation of the fact-finding process, any procedure by which to request records, and how the school should respond.

For a group of borrowers with common facts and claims for which the Secretary determines there may be a borrower defense on the basis of a substantial misrepresentation that was widely disseminated, there would be a rebuttable presumption that all of the members of the group reasonably relied on the misrepresentation.

<u>Reasons</u>: In response to requests by non-Federal negotiators representing students and borrowers, consumer advocacy organizations, and legal assistance organizations, we propose to establish a group claim process that is designed to be simple, accessible, and fair, and to promote greater efficiency and expediency in the resolution of borrower defense claims.

The Secretary would determine whether a group process should be initiated after consideration of relevant factors. We expect that the Secretary would initiate a group process only where there are common facts and claims among the borrowers. These common facts and claims may emerge, for example, from the Department's analysis of individual borrower defense claims; the identification by the Secretary of factors that indicate a school has engaged in substantial misrepresentation that has potentially impacted a group of borrowers; the Department's receipt of a judgment possibly affecting a group of borrowers in the same way; the Department's identification of a breach of contract that may affect a group of borrowers; or, for loans first disbursed before July 1, 2017, the Department's knowledge of a violation of State law relating to the making of Direct Loans or provision of education services affecting a group of borrowers. Evidence for any of these determinations might come from submissions to the Department by claimants, State AGs or other officials, or advocates for claimants, as well as from the Department's investigations.

We also propose that if the Secretary determines that there are common facts and claims that may affect numerous borrowers, the Secretary may include in the group those borrowers whom we can identify from Department records who are likely to have experienced conduct involving common facts as those who have filed, and who could be expected to have similar claims, even if those we identify have not filed a borrower defense application. The Department believes that including such borrowers would allow for faster relief for a broader group of borrowers than if the process is limited to just those who file applications for relief.

In proposed §685.222(f), we specify that, in determining whether to initiate a group process, the Secretary may also consider other factors. These factors include items such as the fiscal impact of considering claims only in individual instances and the significant amount of administrative resources required to consider such claims one by one, the promotion of compliance by pursuing recovery from the schools in aggregated amounts that may affect a school's interests, and the deterrent effect such actions can be expected to have on both the individual school and similarly situated schools. Although the Department intends to carefully weigh the above factors in deciding whether to initiate a group process--which we anticipate will have more formal processes and procedures, involvement by the school, and commitment of administrative resources by the Department--the Department's consideration of such factors for the initiation of a group process would not prevent individual borrowers from obtaining determinations. Individual borrowers would be able to continue to seek relief and obtain determinations as described in proposed §685.222(e), and could also opt out of a group process as described in proposed §685.222(f)(2) at the outset and utilize the process in §685.222(e).

We believe the Secretary is best positioned to make a determination as to whether a group process is appropriate since the Secretary is likely to have the most information regarding the circumstances that warrant use of a group process. However, non-Federal negotiators requested that State AGs and legal assistance organizations be allowed to request that the Secretary initiate a group process and to make submissions in those processes, and that the Secretary be required to issue written responses to such requests and submissions. The Department always welcomes cooperation and input from other Federal and State enforcement entities, as well as legal assistance organizations and advocacy groups. In our experience, such cooperation is more effective when it is conducted through informal communication and contact. Accordingly, we have not incorporated a provision regarding written responses from the Secretary, but plan to create a point of contact for State AGs to allow for active channels of communication on borrower defense issues, and reiterate that we welcome a continuation of cooperation and communication with other interested groups and parties. As indicated above, the Department is also fully ready to receive and make use of evidence and input from other stakeholders, including advocates and State and Federal agencies.

In response to negotiator concerns, the proposed group process is designed to ensure that the school has an opportunity for a full and fair opportunity to be heard regarding claims. We propose that, when the Secretary determines that the group claim process is appropriate, the Department would assume responsibility for presenting the group's claims in the administrative proceeding against the school. Because the administrative proceeding will determine both the validity of the borrowers' claims and the liability of the school to the Department, the Department believes that it is the appropriate party to present the claims. Additionally, by undertaking this role, the Department intends to reduce the likelihood that third parties, such as debt "counselors" or collection companies, are able to prey upon borrowers unfamiliar with the borrower defense process by promoting their services to arrange relief, and to lessen the legal costs and administrative burden to borrowers in the process.

In response to negotiator concerns, we have proposed that a borrower could opt out of a group borrower defense claim action, and instead submit an individual application. This would allow the individual to make his or her own case (with or without legal representation), giving the individual the same right to control the assertion of the individual's claim as would be available in a class action. Fed. R. Civ. Proc. 23(c). A determination made in the administrative proceeding on the group claim would be given substantial weight in any subsequent evaluation of the individual claim of a borrower who "opted out" of the group process.

Finally, for a group of borrowers with common facts and claims for which the Secretary determines there may be a borrower defense on the basis of a substantial misrepresentation that was widely disseminated, there would be a rebuttable presumption that all of the members of the group to which the representation was made reasonably relied on the misrepresentation. If a representation that is reasonably likely to induce a recipient to act is made to a broad audience, we consider it logical to presume that those audience members did in fact rely on that representation. We believe there is a rational nexus between the publication of the misrepresentation and the likelihood of reliance by the audience such that we propose to adopt a rebuttable presumption that all members of the group did in fact so rely.[18] This rebuttable presumption would shift the burden to the school, requiring the school to demonstrate that individuals in the identified group did not in fact rely on the misrepresentation at issue.

Group Process for Borrower Defenses--Closed School (§685.222(g))

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) states that borrowers may assert borrower defenses, but does not establish any process for doing so.

[18] Case law requires no more than such a rational nexus:

> . . [A]dministrative agencies may establish presumptions, "as long as there is a rational nexus between the proven facts and the presumed facts." Cole v. U.S. Dep't of Agric., 33 F.3d 1263, 1267 (11th Cir.1994); Sec'y of Labor v. Keystone Coal Mining Corp., 151 F.3d 1096, 1100-01 (D.C.Cir.1998) (stating that presumptions are permissible "if there is 'a sound and rational connection between the proved and inferred facts'") (quoting Chem. Mfrs. Ass'n v. Dep't of Transp., 105 F.3d 702, 705 (D.C.Cir.1997)). "Appellants bear 'the heavy burden of demonstrating that there is no rational connection between the fact proved and the ultimate fact to be presumed.'" USX Corp., 395 F.3d at 170 (quoting Cole, 33 F.3d at 1267).

U.S. Steel Corp. v. Astrue, 495 F.3d 1272, 1284 (11th Cir. 2007).

Proposed Regulations: Section 685.222(g) of the proposed regulations would establish a process for review and determination of borrower defense claims for groups identified by the Secretary for which the claims relate to Direct Loans to attend a school that has closed and has provided no financial protection currently available to the Secretary from which to recover any losses based on borrower defense claims, and for which there is no appropriate entity from which the Secretary can otherwise practicably recover such losses.

Under proposed §685.222(g)(1), a hearing official would review the Department official's basis for identifying the group and resolve the claim through a fact-finding process. As part of that process, the hearing official would consider any evidence and argument presented by the Department official on behalf of the group and, as necessary to determine any claims at issue, on behalf of individual members of the group. The hearing official would consider any additional information the Department official considers necessary, including any Department records or response from the school or a person affiliated with the school as described in §668.174(b) as reported to the Department or as recorded in the Department's records, if practicable. As discussed under "Borrower Relief (34

CFR 685.222(i) and Appendix A)," the hearing official may also request information as described in §685.222(i)(1).

The hearing official would issue a written decision determining the merits of the group borrower defense claim. If the hearing official approves the borrower defense, that decision would notify the members of the group of that determination and of the relief provided on the basis of the borrower defense claim. If the hearing official denies the borrower defense in full or in part, that decision would state the reasons for the denial, the evidence that was relied upon, the portion of the loans that are due and payable to the Secretary, and whether reimbursement of amounts previously collected is granted, and would inform the borrowers that if any balance remains on their respective loans, the loans will return to their statuses prior to the group process. The Secretary would provide copies of the written decision to the members of the group, and, as practicable, to the school.

Similar to the individual claim process, the hearing official's decision would be final as to the merits of the group borrower defense and any relief that may be granted on the group borrower defense. However, if relief for the group was denied in full or in part, an individual borrower would be able to request that the Secretary reconsider the borrower defense upon the identification of new evidence in support of the borrower's individual borrower defense claim as described in proposed §685.222(e)(5)(i). Additionally, the proposed regulation provides that the Secretary may also reopen a borrower defense application at any time to consider evidence that was not considered in making the previous decision.

Reasons: When a group borrower defense is asserted with respect to Direct Loans to attend a school that has closed and has provided no financial protection currently available to the Secretary from which to recover any losses based on borrower defense claims, and for which there is no appropriate entity such as a corporate owner of a school from which the Secretary can otherwise practicably recover such losses,[19] the proposed regulations on the process for resolving the claim would focus on the arguments and evidence that may be brought by the Department official before a hearing official.

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[19] In some instances, the Department may consider a school owned by a corporate parent to be financially responsible based on an evaluation of the consolidated balance sheets of the school, the parent corporation, and affiliated subsidiaries. 34 CFR 668.23(d)(2). If the school is considered to be financially responsible only based on the assets of the consolidated entities, the Department requires the parent corporation to execute the Program Participation Agreement by which the school participates.

We expect that the fact-finding process in this case would occur after a school has liquidated its assets and, thus, would not typically involve the school. The evidence and records used to make a determination would be largely composed of the common facts and claims that served as the basis for forming the group.

While this group borrower defense process would not typically involve the school, a hearing official would still preside over the fact-finding process to ensure that the decision is based on a sound and thorough evaluation of the merits of the claim. The hearing official would consider the arguments and evidence presented by the designated Department official and, as discussed under "Borrower Relief (34 CFR 685.222(i) and Appendix A)," may also request information under proposed §685.222(i)(1).

<u>Group Process for Borrower Defense Claims--Open School (§685.222(h))</u>

<u>Statute</u>: 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.

<u>Current Regulations</u>: Section 685.206(c) states that borrowers may assert borrower defenses, but does not establish any process for doing so.

Proposed Regulations: Proposed §685.222(h) would establish the following process for groups identified by the Secretary for which the borrower defense is asserted with respect to Direct Loans to attend an open school.

A hearing official would resolve the borrower defense and determine any liability of the school through a fact-finding process. As part of the process, the hearing official would consider any evidence and argument presented by the school and the Department official on behalf of the group and, as necessary, evidence presented on behalf of individual group members. As discussed under "Borrower Relief (34 CFR 685.222(i) and Appendix A)," the hearing official may also request information as described in §685.222(i)(1).

The hearing official would issue a written decision, regardless of the outcome of the group borrower defense. If the hearing official approved the borrower defense, that decision would describe the basis for the determination, notify the members of the group of the relief provided on the basis of the borrower defense, and notify the school of any liability to the Secretary for the amounts discharged and reimbursed.

If the hearing official denied the borrower defense in full or in part, the written decision would state the reasons for the denial, the evidence that was relied upon, the portion of the loans that are due and payable to the Secretary, whether reimbursement of amounts previously collected is granted, and would inform the borrowers that their loans--in the amounts determined to be enforceable obligations--will return to their statuses prior to the group borrower defense process. It also would notify the school of any liability to the Secretary for any amounts discharged. The Secretary would provide copies of the written decision to the members of the group, the Department official, and the school.

The hearing official's decision would become final as to the merits of the group borrower defense claim and any relief that may be granted within 30 days after the decision is issued and received by the Department official and the school unless, within that 30-day period, the school or the Department official appeals the decision to the Secretary. A decision of the hearing official would not take effect pending the appeal. The Secretary would render a final decision following consideration of any appeal.

After a final decision has been issued, if relief for the group has been denied in full or in part, a borrower may file an individual claim for relief for amounts not discharged in the group process. In addition, the Secretary may reopen a borrower defense application at any time to consider evidence that was not considered in making the previous decision, as discussed above.

The Secretary would collect from the school any amount of relief granted by the Secretary for the borrowers' approved borrower defense. Relief may include discharge of some or all accrued interest, and the loss to the government in those instances will include that discharged interest.

Reasons: The group borrower defense process involving an open school would be structured to provide substantive and procedural due process protections to both the borrowers and the school. By having a Department official present the group's borrower defense claims, the Department seeks to lessen, if not eliminate, the need for borrowers to retain counsel in order to pursue relief and remove potential difficulties that navigating the borrower defense process could present for borrowers. As proposed, schools would have the opportunity to raise arguments and evidence, including any defenses, in the proceeding. Additionally, as discussed under "Borrower Relief (34 CFR 685.222(i) and Appendix A)," the hearing official may also independently request information as described in §685.222(i)(1).

The open school process would also provide for an appeal to the Secretary of the hearing official’s decision, by either the school or the Department official. The proposed regulations would allow individual members of the group to request reconsideration of their individual claims upon the presentation of new evidence in the event the group claim is not successful.

Non-Federal negotiators requested clarification as to whether a hearing official’s determination of borrower relief in the open school process would be contingent upon the Department’s ability to recover its losses from granting such relief from the school. The final decision of the hearing official, or of the Secretary upon appeal, would determine the amount of relief to be awarded, which in turn would determine the amount of losses to the Secretary that the Department can then collect from the school under proposed §685.222(h)(5). However, while the final decision will include a determination as to a school’s liability for the conduct in question, the Department intends that determinations of borrower relief will be independent of, and not contingent upon, determinations of school liability that will lead to the Department’s ability to recover the losses it incurs from granting such relief.

Borrower Relief (§685.222(i) and Appendix A)

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) states that, in the event of a successful borrower defense claim against repayment, the Secretary would notify the borrower that he or she is relieved of the obligation to repay all or part of the loan and associated costs and fees, and also affords the borrower further appropriate relief. This further relief may include, but is not limited to, reimbursement for amounts paid toward the loan voluntarily or through enforced collection, a determination that the borrower is not in default and is eligible to receive title IV, HEA program aid, and updating reports to consumer reporting agencies.

Proposed Regulations: Proposed §685.222(i)(1) describes the proposed process by which a borrower's relief would be determined when a borrower defense claim is approved under the procedures in §685.222(e), (g), or (h). The Department official or--for group claims, the hearing official--charged with adjudicating the claim would determine the appropriate method for calculating, and amount of, relief arising out of the facts underlying the borrower’s claim, based upon the information gathered by, or presented to and considered by, the official. The amount of relief may include a discharge of all amounts owed to the Secretary on the loan at issue and may include the recovery of amounts previously collected by the Secretary on the loan, or some lesser amount. The official would consider the availability of information required for a method of calculation and could use one or more of the methods described in Appendix A to the proposed regulations, or some other method determined by the official. For group claims, the official could consider information from a sample of borrowers in the group.

The designated Department official would notify the borrower of the relief determination and the potential for tax implications and would provide the borrower an opportunity to opt out of group relief, if applicable.

Consistent with the determination of relief, the Secretary would discharge the borrower’s obligation to repay all or part of the loan and associated costs and fees that the borrower would otherwise be obligated to pay and, if applicable, would reimburse the borrower for amounts paid to the Secretary toward the loan voluntarily or through enforced collection.[20]

The Secretary or the hearing official, as applicable, would afford the borrower such further relief as the Secretary or the hearing official determines is appropriate under the circumstances. That relief would include, but not be limited to, determining that the borrower is not in default on the loan and is eligible to receive assistance under title IV of the HEA, and updating reports to consumer reporting agencies to which the Secretary previously made adverse credit reports with regard to the borrower's Direct Loan.

The total amount of the relief granted with respect to a borrower defense cannot exceed the amount of the loan and any associated costs and fees, and would be reduced by the amount of any refund, reimbursement, indemnification, restitution, compensatory damages, settlement, debt

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[20] Reimbursement includes only the actual gross amount paid, including any amount used to defray collection costs, but does not include interest on the amount paid.

> "Under the long-standing 'no-interest rule,' sovereign immunity shields the U.S. government from interest charges for which it would otherwise be liable, unless it explicitly waives that immunity[.]" Sandstrom v. Principi, 358 F.3d 1376, 1379 (Fed.Cir.2004).

DMS Imaging, Inc. v. United States, 123 Fed. Cl. 645, 660 (2015). There is no waiver of that immunity in the HEA.

forgiveness, discharge, cancellation, compromise, or any other benefit received by, or on behalf of, the borrower that was related to the borrower defense. The relief to the borrower may not include non-pecuniary damages such as inconvenience, aggravation, emotional distress, or punitive damages.

Appendix A describes some of the methods the Secretary could employ to calculate relief if the requested relief for a borrower defense is approved in full or in part. The amount of relief may include a cancellation of the outstanding balance on the loan at issue, or some lesser amount, and may include the recovery of amounts previously collected by the Secretary on the portion of the loan determined to be not enforceable against the borrower as a result of the borrower's claim, taking into account any limiting factors such as applicable limitation periods or statutes of limitation. The methods described include the following:

- The difference between what the borrower paid and what a reasonable borrower would have paid had the school made an accurate representation as to the issue that was the subject of the substantial misrepresentation underlying the borrower defense claim;

- The difference between the amount of financial charges the borrower could have reasonably believed the school was charging, and the actual amount of financial charges made by the school, for claims regarding the cost of a borrower’s program of study; and

- The total amount of the borrower’s economic loss, less the value of the benefit, if any, of the education obtained by the borrower. Economic loss, for the purposes of this section, may be no greater than the amount of the cost of attendance. The value of the benefit of the education may include transferable credits obtained by the borrower,, and, for gainful employment programs, qualifying placement in an occupation within the Standard Occupational Classification (SOC) code for which the training was provided, provided that the borrower’s earnings meet the expected salary for the program’s designated occupation(s) or field, as determined using an earnings benchmark for that occupation. The Department official or hearing official will consider any evidence indicating that no identifiable benefit of the education was received by the student.

The Secretary may also calculate the borrower’s relief on the basis of such other measures as the Secretary may determine.

Reasons: The proposed regulations provide for the determination of relief commensurate with the borrower's injury stemming from the act or omission of the school asserted in the borrower defense claim. While some borrower defenses may merit a discharge of the full amount of the Direct Loan, other claimants may prove an injury in an amount less than that full amount. After considering relevant facts and data, the Department official or the hearing official, as applicable, would determine an amount of relief that is fair to the borrower. This approach would compensate borrowers fairly for the harm they suffered while protecting the fiscal interests of the Federal government.

Proposed §685.222(i)(5) would provide that the relief provided to a borrower under §685.206(c) or §685.222 may not exceed the amount of the Direct Loan and associated costs and fees. The Department's ability to provide relief for borrowers is predicated upon the existence of the borrower's Direct Loan, and the Department's ability to provide relief for a borrower on a Direct Loan is limited to the extent of the Department's authority to take action on such a loan. Section 455(h) of the HEA, 20 U.S.C. 1087e(h), gives the Department the authority to allow borrowers to assert "a defense to repayment of a [Direct

Loan],” and discharge outstanding amounts to be repaid on the loan. However, section 455(h) also provides that “in no event may a borrower recover from the Secretary . . . an amount in excess of the amount the borrower has repaid on such loan.” As a result, the Department may not reimburse a borrower for amounts in excess of the payments that the borrower has made on the loan to the Secretary as the holder of the Direct Loan. Additionally, proposed §685.222(i)(5) would reduce a borrower’s amount of relief from the borrower defense process by any amounts that the borrower obtained pursuant to such other sources for reasons discussed under “Process for Individual Borrowers (34 CFR 685.222(e)).” The rule is intended to prevent a double recovery for the same injury at the expense of the taxpayer. Because the borrower defense process relates to the borrower’s receipt of a Federal loan, we would reduce the amount of a borrower’s relief from the borrower defense process by the amount received from such other sources only if the relief from the other sources also relates to the Federal loan that is the subject of the borrower defense.

Additionally, proposed §685.222(i)(5) would also clarify that a borrower may not receive non-pecuniary damages such as damages for inconvenience, aggravation, emotional distress, or punitive damages. We recognize that, in certain civil lawsuits, plaintiffs may be awarded such damages by a court. However, such damages are not easily calculable and may be highly subjective. The Department believes that excluding non-pecuniary damages from relief under this rule would help produce more consistent and fair results for borrowers.

Subject to these limitations, the Department's proposal would require that the designated Department official, or hearing official, as applicable, determine the appropriate method for calculating the relief to the borrower and the amount of such relief, whether relief to the borrower was approved in full or in part. Determinations on borrower defenses may vary widely, depending on the underlying basis of the claim and circumstances alleged, as well as the level of injury suffered by or detriment to the borrower. For example, for a borrower defense claim brought for a breach of a discrete contractual term such as a school's failure to provide some specific service, the borrower's injury may be more appropriately calculated in consideration of the value of that service and may not warrant a full discharge of the borrower's loan and full reimbursement of payments on the loan made to the Secretary. For example, if the school contractually promised to provide tutoring services, but failed to provide such services, then the borrower would receive the cost of such tutoring services as relief under the proposed method.

We also recognize that the feasibility of any particular method of calculation may be limited due to a lack of available information required for such a method. Information regarding tuition prices among comparable programs in a specific geographic region may not be available or suitable for use in the calculation of relief for an individual borrower’s claim, but may in certain circumstances be available and relevant for the calculation of relief for a group of borrowers. To permit the Department official or the hearing official, as applicable, to determine the appropriate method of calculation and to determine relief, the proposed regulations would provide that the official may request information for such purposes. Additionally, the proposed regulations would require the official to consider what information may be feasibly obtained in selecting a method of calculation and in making requests for information.

For determinations of relief for a group of borrowers pursuant to §685.222(g) and (h), the Department also believes it is appropriate to allow the hearing official to consider evidence from a sample of borrowers from the group. The proposed group claim processes are designed to facilitate the efficient adjudication of borrower defenses with common facts and claims. We believe that allowing a calculation of relief based upon information from a sample of borrowers would facilitate this goal. However, the hearing official would consider in each case the feasibility of using a sample, and the method of determining the sample, in determining the appropriate method for calculating relief.

In proposed §685.222(i)(1), the Department also cross-references proposed Appendix A to subpart B of part 685, which lists specific methods by which a borrower's relief may be calculated. Appendix A notes that the amount of the borrower's relief may include a discharge of all amounts owed to the Secretary on the loan at issue, or a lesser amount, and may include the recovery of amounts previously collected by the Secretary on the loan. The Department recognizes that the choice and use of any method listed in Appendix A may vary depending on the availability of information and underlying facts and claims for the borrower defense, as noted in paragraph (i)(1), and also notes that the designated Department official or hearing official, as applicable, may use another method that is not listed to calculate relief. However, the Department proposes the methods in Appendix A as possible methodologies for a designated Department official or hearing official, as applicable, to consider in determining calculations for relief.

The first proposed method in Appendix A applies in the case of a substantial misrepresentation and looks to the difference between what was actually paid by a borrower in reliance on a misrepresentation, and what the borrower would have paid if the borrower had been given an accurate understanding of the subject of the substantial misrepresentation. The item at issue in the substantial misrepresentation could include the total cost of attendance at a school, or could pertain to a specific service related to the making of the borrower’s Direct Loan or the provision of educational services for which the loan was provided. In some situations, as when the borrower receives education that proves to be worthless, a substantial misrepresentation may warrant full relief, without further analysis. However, in other situations, the Department believes it may be appropriate to determine a borrower’s relief by restoring to the borrower the value of what he or she paid for, but did not receive. We believe that such an approach is consistent with the Department’s interest in providing relief to borrowers for the harm they suffered while protecting the Federal taxpayer and the interests of the Direct Loan Program.

The second proposed method in Appendix A looks to the difference between the amount of financial charges a borrower reasonably believed that a school was charging, and the actual amount of charges made by the school regarding the cost of a borrower's program of study. For example, if a school misrepresented the amount of a participation fee or the costs of books for a specific class, under this method, the borrower would be entitled to the difference between what the borrower reasonably thought the charges were as represented by the school, and the actual costs of such items. To the extent that a borrower did, for example, participate in such an experience or did receive the books, we believe that such an approach balances the borrower's interest in paying actual costs with the Department's interest in protecting the Federal taxpayer.

The third proposed method in Appendix A is based on the concept that, if circumstances warrant, a borrower may be entitled to receive the total amount of his or her economic loss. Economic loss may not be greater than the borrower's cost of attendance, which is a term defined in section 472 of the HEA, 20 U.S.C. 1087ll. Pursuant to section 472, a borrower may obtain Federal financial aid up to the cost of attendance at a school and may use that aid only for expenses related to attendance, which include costs such as tuition and fees; allowances for books, supplies, transportation, and miscellaneous personal expenses; allowances for room and board; and allowances for dependent care for students with dependents, among others. The Department has stated that it will recognize borrower defenses only if they are directly related to the making of a Direct Loan or to the school's provision of educational services for which the loan was provided. 60 FR 37768, 37769. Section 484(a)(4)(A) of the HEA requires the borrower to commit to use title IV, HEA funds received only to pay expenses incurred to attend the school. By clarifying that a borrower's relief under the proposed method may be no greater than the borrower's cost of attendance at the school, the proposed approach would avoid the difficulty of attempting to track which particular expense the borrower paid with the loan proceeds, as opposed to those paid with grant funds or personal funds. It would do so by including only those costs that Congress considered to be costs that all title IV, HEA applicants would incur and warrant Federal consideration and support. The third proposed method would also note that the relief measured will be reduced by the value of the benefit, if any, of the education. We recognize that under some circumstances, a borrower's education will be deemed to have no value, and thus the borrower's relief would be measured by the borrower's total economic loss, subject to the limit that the borrower's relief can only be approved up to the amount of the borrower's Direct Loan. The proposed method explicitly states that the Department official, or hearing official, will consider any evidence that no benefit was received by the student. However, in other circumstances, we believe it will be appropriate for a designated Department official or hearing official, as applicable, to consider the value provided by the education, as determined by the official. For example, if a borrower obtained transferrable credits, then the borrower can use those credits towards the completion of his or her education at another school, thus reducing his or her cost of attendance at that other institution. However, if transferability of those credits is limited due to the school's accreditation or for other reasons, then the hearing official or designated Department official may consider such factors and assign due value to the credits. Similarly, for gainful employment programs, where the explicit purpose of such programs is to train students for specific vocations, the Department believes it could be appropriate to consider whether the borrower obtained qualifying placement with earnings commensurate with the expected earnings for the occupation or field for which the borrower obtained his or her training. The expected salary would be determined using an earnings benchmark for that occupation. Although the proposed method would note transferable credits and qualifying placement and earnings for gainful employment program borrowers as possible indicators of value, this list is not exhaustive and the hearing official or designated Department official would be permitted to also consider other factors. As with the other proposed methods, we believes this approach balances the interest of the Federal taxpayer with a borrower's interest in paying for only the true cost of his or her education, in light of the act or omission of the school giving rise to the borrower defense.

Non-Federal negotiators requested that the Department create a presumption of full discharge and reimbursement of amounts paid on the loan whenever a borrower defense is approved by the Department. In cases where a Department official is making determinations, under proposed §685.222(e), such a presumption would shift the burden of disproving loss to the Department. In cases where a group process has been initiated under proposed §685.222(f)-(h), this burden would be shifted to the school. However, as noted, the Department has a responsibility to protect the interests of Federal taxpayers and such burden shifting is not justified when losses from borrower defenses may be borne by the taxpayer. The Department believes that to balance its interest in protecting the taxpayer with its interest in providing fair outcomes to borrowers, the Department must consider the extent to which claimants actually suffered financial loss when determining relief. In proposing that designated Department officials and hearing officials consider such calculations, however, the Department does not preclude full relief for borrowers; rather, such officials would carefully consider available evidence and make reasoned determinations as to when and whether full relief is justified.

Proposed §685.222(i)(2) lists certain items the designated Department official or hearing official would include in the notification to the borrower of the relief determination. Given that the Department does not have the authority to determine the tax implications for relief in borrower defenses, which is within the jurisdiction of the Internal Revenue Service, the notice would simply advise the borrower that accepting the relief could affect the borrower's tax obligations. The Department would encourage any borrower who receives relief to seek advice from tax professionals on the tax implications of his or her acceptance of that relief.

Relief granted through the group processes described in proposed §685.222(f) to (h) may raise specific concerns for members who did not file an application for borrower defense or members who may not have been engaged in the process to their satisfaction. As a result, for determinations of relief for a group of borrowers, the notice would also provide members of the group with an opportunity to opt out of the relief determination. This would provide borrowers in a group process with a second opportunity to opt out of the proceeding, in addition to the opt-out provided by the notice given at the initiation of the group process described in proposed paragraph (f)(2). If a borrower declines to accept the relief determination from the group process, the borrower may choose to have his or her borrower defense considered on an individual basis through the process described in proposed paragraph (e) of this section. As noted earlier, the decision of the hearing official in a group proceeding would likely bear strongly on the resolution of the borrower's claim, if pursued on an individual basis.

Borrower cooperation and transfer of rights (§685.222(j) and (k))

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: Current borrower defense regulations (§685.206(c)) do not address borrower cooperation or the transfer of rights.

Proposed Regulations: Section 685.222(j) of the proposed regulations would require that a borrower seeking relief through the borrower defense process reasonably cooperate with the Secretary, whether relief is sought through an individual application filed under proposed §685.222(e) or through the group processes described in proposed §685.222(f) to (h). The Secretary would be permitted to revoke relief granted to a borrower who does not fulfill this obligation.

In addition, proposed §685.222(k) would provide that, when the Secretary grants relief in response to a borrower defense claim, 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 contract for educational services for which the loan was received, against the school, its principals, its affiliates, and their successors, its sureties, and any private fund. If the borrower asserts and recovers on a claim with a public fund, and if the Secretary determines that the borrower's recovery from that public fund was based on the same claim raised as a borrower defense and for the same loan for which the discharge was granted, the Secretary may reinstate the borrower's obligation to repay the amount discharged on the loan based on the amount recovered from the public fund.

Proposed §685.222(k) would 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. However, §685.222(k) would not prevent a borrower from pursuing relief against any party named in §685.222(k) for claims in excess of what has been assigned to the Secretary, or for claims unrelated to the basis of the borrower defense on which the borrower received relief.

Reasons: When a borrower seeks a discharge of a Direct Loan, the Department would require the borrower's cooperation to determine the facts of the claim and provide the school with due process, as appropriate. Absent this cooperation, the Department could be unable to successfully resolve the borrower's request for relief. Similarly, for the reasons discussed for requesting such information on claims to third parties under "Process for Individual Borrowers (34 CFR 685.222(e))," it is important that the Department prevent double recovery for the same claim, when the borrower has already recovered from another source.

Borrower Responsibilities and Defenses (§685.206)

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 borrower defense, the relief afforded by the Secretary in the event the borrower's claim is successful, and the Secretary's authority to recover from the school any loss that results from a successful borrower defense. Specifically, §685.206(c) provides that a borrower defense may be asserted 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. Under §685.206(c), a borrower defense is presumed to be raised only in response to 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 31 U.S.C. 3720D, salary offset proceedings for Federal employees under 34 CFR part 31, and consumer reporting proceedings under 31 U.S.C. 3711(f). Under §685.206(c), if a borrower defense is successful, the borrower is relieved of the obligation to pay all or part of the loan and associated costs and fees, and the borrower may be afforded such further relief as the Secretary determines is appropriate, including, among other things, reimbursement of amounts previously paid toward the loan. Although §685.206(c) permits the Secretary to seek recovery from the school of the amount of the loan to which the borrower defense applies, it also provides that the Secretary may not initiate such a proceeding after the three-year record retention period referenced in §685.309(c).

Proposed Regulations: Proposed §685.206(c) would specify that it applies only to borrower defenses asserted with respect to Direct Loans disbursed prior to July 1, 2017. It would clarify that a borrower defense must relate to the making of the Direct Loan or the provision of educational services and define “borrower defense” to include one or both of the following: a defense to repayment of amounts owed to the Secretary on a Direct Loan, in whole or in part; and a right to recover amounts previously collected by the Secretary on the Direct Loan, in whole or in part. Proposed §685.206(c) would also exclude the language that specifically refers to the Department’s defaulted loan collection proceedings.

Rather than specifying the available relief in proposed §685.206(c) for an approved borrower defense, proposed §685.206(c)(2) would refer to proposed §685.222(e)-(k), which would provide procedures for both the assertion and the resolution of a borrower defense claim, including available relief for an approved borrower defense.

Proposed §685.206(c)(2) also would refer to proposed §685.222(a) for applicable definitions and to specify the order in which the Department would process multiple loan discharge claims submitted by the same borrower for the same loan or loans. Under proposed §685.222(a)(6), the Secretary would determine the order in which multiple loan discharge claims submitted by the same borrower for the same loan or loans are processed, and notify the borrower of that order.

Proposed §685.206(c) would continue to permit the Secretary to initiate a proceeding to recover from the school the amount of relief arising from an approved borrower defense, but it would remove the three-year limitation on the Secretary's ability to initiate such a proceeding.

Reasons: The introduction of a definition of "borrower defense" streamlines the regulations. The proposed updates to §685.206 provide clarity to borrowers who have loans first disbursed prior to July 1, 2017, and who are seeking relief based on a borrower defense claim. The Department considered whether to change the standard by which a borrower may assert a borrower defense for loans disbursed prior to the anticipated effective date of these regulations, or July 1, 2017. However, the existing Direct Loan promissory notes incorporate the current borrower defense to repayment process for loans first disbursed before July 1, 2017, which is based on an 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. As a result, the Department has decided to keep the current standard for loans first disbursed prior to July 1, 2017. Acts or omissions that may give rise to a cause of action under applicable State law may include any cause of action pertaining to the making of the Direct Loan or the provision of educational services for which the loan was provided. Similarly, other applicable State law principles governing the State law cause of action would apply, such as any applicable State law statutes of limitation.

We discuss under "Borrower Defenses--General (§685.222(a))" the Department's reasons for clarifying that the Department will acknowledge a borrower defense asserted under the regulations "only if the cause of action directly relates to the loan or to the school's provision of educational services for which the loan was provided." 60 FR 37768, 37769. We also discuss the reasons for the proposed definition of "borrower defense" in that part of this NPRM.

Proposed §685.206(c) would exclude the language that specifically refers to the Department's defaulted loan collection proceedings. While many loans that are the subject of a borrower defense may be in default, the Department has committed in this proposed rulemaking to establish a process outside of the defaulted loan collection proceedings to evaluate borrower defenses for loans regardless of whether the loans are in default or not. We believe that establishing such a dedicated process will enhance the Department’s efforts to review and process borrower defenses and offer borrowers more consistent and focused relief.

We also propose to amend §685.206 to refer to a new section of the regulations, §685.222, for the process to be followed when pursuing a borrower defense claim. Proposed §685.222 would provide an expanded description of the regulatory framework for the range of borrower defense claims, including the process by which claims and relief are determined.

Proposed §685.206(c)(2) would refer to proposed §685.222(a)(6), which addresses the order in which multiple claims for loan discharge from the same borrower for the same loan or loans will be processed by the Secretary. The proposed language indicates that, if the borrower asserts both a borrower defense and any other objection to an action of the Secretary with regard to that Direct Loan, the Secretary notifies the borrower of the order in which the borrower defense and any other objections will be considered. During the negotiated rulemaking process, a non-Federal negotiator requested that further clarification be provided regarding the order in which claims will be determined. The Department did not agree that it was appropriate to do so within the proposed regulations, since the particular circumstances may vary and establishing one order for all cases could result in a progression that could be unfair to individual borrowers. In general, we will evaluate claims in the order that is likely to result in a decision for the borrower sooner, while also effectively and efficiently using the Department's resources.

While a borrower may still assert a borrower defense in connection with the Department's defaulted loan collection proceedings, the Department's current experience with borrower defense claims from Corinthian students suggests that such claims are more likely to arise outside of such proceedings. However, it is not clear whether this will be true in the future.

The existing Direct Loan promissory notes incorporate the current borrower defense to repayment process for loans first disbursed before July 1, 2017, which is based on an 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. Because current regulations in §685.206(c) do not include a process for submission and consideration of claims, the Department intends to extend to borrowers with loans first disbursed before July 1, 2017, the processes developed to submit, review, and resolve borrower defense claims for borrowers with loans first disbursed on or after July 1, 2017.

The Department is also proposing to remove the limitation period on the Department's ability to initiate a proceeding to recover losses from approved borrower defenses. We explain the reasons for this proposed change under the discussion for §685.206 and §685.308, "Remedial Action and Recovery from the Institution."

<u>150 Percent Direct Subsidized Loan Limit (§685.200)</u>

<u>Statute</u>: 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 (thereinafter referred to as the "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 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 school closure, false certification, unpaid refund, or 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.

The proposed regulations would also specify that, when the complete 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, defense to repayment or unpaid refund discharge, the Department would completely discharge a Direct Subsidized Loan or a portion of a Direct Subsidized Consolidation Loan that is a 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 is recalculated instead of eliminated. Depending on the circumstances, discharges due to defense to repayment and unpaid refund could result in only part of a Direct Subsidized Loan or a portion 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 instead of eliminated, the period is only recalculated when 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 and 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 and 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 school closure, false certification, unpaid refund, or defense to repayment 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 three years' worth of Direct Subsidized Loans at school A and then transfers to school B and receives three additional years' worth of Direct Subsidized Loans. Further suppose that at this point, the borrower has no remaining 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 codify the Department's current practice in this area and would provide clarity in the Department's policies and practices. Under the circumstances in which a borrower receives a closed school, false certification, defense to repayment, or unpaid refund discharge, a borrower has not received all or part of the benefit of the loan due to an act or omission of the school. In such 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 all or a portion of such loan. Accordingly, under the proposed regulations, we would increase the borrower's eligibility for Direct Subsidized Loans or reinstate 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.

Administrative Forbearance (§685.205(b)(6))

Statute: Section 428(c)(3) of the HEA provides for the Secretary to permit FFEL Program lenders to exercise administrative forbearances that do not require the agreement of the borrower, under conditions authorized by the Secretary. Section 455(a) provides that Direct Loans have the same terms, conditions, and benefits as FFEL Loans.

Current Regulations: Section 685.205(b) of the current regulations describes the circumstances under which the Secretary may grant forbearance on a Direct Loan without requiring documentation from the borrower. Section 685.205(b)(6) specifies that these circumstances include periods necessary for the Secretary to determine the borrower's eligibility for a closed school discharge, a false certification of student eligibility discharge, an unauthorized payment discharge, an unpaid refund discharge, a bankruptcy discharge, and teacher loan forgiveness.

Proposed Regulations: We propose to add to §685.205(b)(6) a mandatory administrative forbearance when the Secretary is in receipt of, and is making a determination on, a discharge request based on a claimed borrower defense. The proposed changes would add cross-references to the regulations on borrower defense claims (§§685.206(c) and 685.222). By these references, we would expand the circumstances under which the Secretary may grant forbearance on a Direct Loan without requiring documentation from the borrower.

Reasons: During the Department's review of a borrower defense, we believe borrowers seeking relief should have the option to continue to make payments on their loans, as well as the option to have their loans placed in forbearance. Providing an automatic forbearance with an option for the borrower to decline the temporary forbearance and continue making payments would reduce the potential burden on borrowers pursuing borrower defenses.

Mandatory Administrative Forbearance for FFEL Program Borrowers (§682.211)

Statute: Section 428(c)(3)(D) of the HEA provides for the Secretary to permit lenders to provide borrowers with certain administrative forbearances that do not require the agreement of the borrower, under conditions authorized by the Secretary.

Current Regulations: Section 682.211(i) specifies the circumstances under which a FFEL lender must grant a mandatory administrative forbearance to a borrower. The current regulations do not address circumstances in which a borrower has asserted a borrower defense with respect to a loan.

Proposed Regulations: Proposed §682.211(i)(7) would require a lender to grant a mandatory administrative forbearance to a borrower upon being notified by the Secretary that the borrower has submitted an application for a borrower defense discharge related to a FFEL Loan that the borrower intends to pay off through a Direct Loan Program Consolidation Loan for the purpose of obtaining relief, as reflected in proposed §685.212(k). The administrative forbearance would remain in effect until the Secretary notifies the lender that a determination has been made as to the borrower's eligibility for a borrower defense discharge. If the Secretary notifies the borrower that he or she would qualify for a borrower defense discharge if he or she were to consolidate, the borrower would then be able to consolidate the loan(s) to which the defense applies. If the borrower then obtains the Direct Consolidation Loan, the Secretary would recognize the defense and discharge that portion of the Consolidation Loan that paid off the FFEL Loan in question.

Reasons: We are proposing to change the Direct Loan forbearance regulations in §685.205(b)(6) to provide for the Secretary to grant an administrative forbearance to a Direct Loan borrower during the period when the Secretary is determining the borrower's eligibility for a borrower defense discharge. Some non-Federal negotiators believed that a comparable forbearance benefit should be provided to FFEL Program borrowers who believe that they have a defense to repayment on a FFEL Loan and intend to seek relief under the Direct Loan borrower defense provisions by consolidating the FFEL Loan into a Direct Consolidation Loan, as addressed in proposed §685.212(k). As described more fully below regarding proposed §685.212, that section will be amended to address how a Direct Consolidation Loan borrower may assert a defense to repayment of that Consolidation Loan based on an act or omission of a school the borrower attended using the Direct Loan, FFEL Stafford or PLUS Loan, or a Perkins Loan paid off by that Consolidation Loan. If the borrower defense claim is approved in full, for example, the Secretary would discharge the portion of the Direct Consolidation Loan that paid off the Direct Loan, FFEL Loan, or Perkins Loan. Non-Federal negotiators requested that the mandatory administrative forbearance provisions for FFEL Program borrowers who are seeking relief based on a borrower defense claim be amended to mirror the mandatory administrative forbearance provisions for Direct Loan borrowers who are seeking relief under borrower defense. The Department agreed that this was appropriate and proposes to revise §682.211 to provide this benefit.

Discharge of a Loan Obligation (§685.212)

Statute: Section 455(h) of the HEA provides that the Secretary may specify in regulations which acts or omissions of a school a borrower may assert as a defense to repayment of a Direct Loan. This provision allows for the discharge of the borrower’s Direct Loan pursuant to the regulations regarding borrowers’ defenses to repayment.

Current Regulations: Current §685.212 states those grounds specified or explicitly referenced in sections 437 and 455(m) of the HEA, and section 6 of Pub. L. 109-382 (authorizing September 11 survivors discharge), on which the Secretary discharges some or all of a borrower’s obligation to repay a Direct Loan. These grounds include death, disability, closed school, false certification, bankruptcy, teacher loan forgiveness, public service loan forgiveness, and September 11 survivors discharge.

Proposed Regulations: We propose to amend §685.212 to include discharge of all or part of a borrower’s Direct Loan obligation by reason of a borrower defense that has been approved under §685.206(c) or proposed §685.222. The proposed addition would also specify that, with respect to a Direct Consolidation Loan for which a borrower defense was approved, the Secretary would provide relief as to the portion of the Consolidation Loan obligation that repaid the original Direct Loan, FFEL Loan, Perkins Loan or other federally financed student loan used to attend the school to which the borrower defense claim relates. The proposed addition would further describe the standard we would apply to consideration of borrower defense claims raised by borrowers to Direct Consolidation Loans and to claims for return of payments and recoveries on the Consolidation Loan itself, and to payments and recoveries on the Federally-financed loans that were paid off by the Direct Consolidation Loan.

Reasons: The proposed changes to §685.206(c) and proposed new §685.222 include new language establishing the grounds on which a borrower's obligation to repay a Direct Loan may be discharged. This proposed change to §685.212 would clarify current policy and provide for a more complete set of cross-references to the loan discharge types covered in §685.212.

The proposed changes would also clarify that an appropriate portion of a borrower's obligation to repay a Direct Consolidation Loan may be discharged, if a borrower defense has been approved pursuant to §685.206(c) or proposed §685.222. Section 455(h) of the HEA provides that the Secretary may allow for the discharge of a loan pursuant to a borrower defense for a loan made "under this part"--the Direct Loan Program. This includes Direct Consolidation Loans made under section 455(g) of the HEA. This proposed change to §685.212 is also meant to clarify current policy regarding the types of loans for which a borrower defense may be asserted, and how a borrower's obligation to repay a Direct Consolidation Loan is affected if a borrower defense claim has been approved under §685.206(c) and proposed §685.222. Because the act or omission of the school that would constitute a borrower defense under §685.206(c) or proposed §685.222 would pertain to the making of the Federal loans that were consolidated into his or her Direct Consolidation Loan or the provision of educational services for such Federal loans, the proposed language would clarify that relief for a borrower defense approved as to a Direct Consolidation Loan will be provided for that portion of the Consolidation Loan that corresponds to the original loan obtained to attend the school whose act or omission gave rise to a borrower defense. Thus, §685.212 would be amended in new paragraph (k) to list the Federal education loans that may be paid off by a Direct Consolidation Loan and with regard to which the borrower may assert a borrower defense claim. Those original loans include the loans listed in §685.220. For some of the discharges already listed in this section, the relief available is explained here; for others, the relief is described only in the specific regulations that describe the grounds and procedure for obtaining relief. Some of the discharges already listed provide only relief from the obligation to repay the remaining outstanding balance on the loan, while others, such as closed school discharges, may provide for both debt relief and refund of payments already recovered. The relief available for each of the listed discharges is controlled by the law on which the discharge is based; the basis and relief available for borrower defense discharges are stated fully in §685.206(c) and proposed §685.222 and will be reflected in the new §685.212(k).

Thus, §685.212 would be amended to clarify that the Secretary would evaluate a borrower defense claim on a Direct Loan using the standards stated in §685.206(c) or, for loans first disbursed, or made, on or after July 1, 2017, in §685.222. The standard that would be applied would depend upon factors such as the date that the Direct Consolidation Loan was first made; whether the underlying loan to which a borrower defense is asserted is a Direct Loan or some other eligible loan for consolidation; and whether the issue at hand refers either to a borrower's defense to repayment to the applicable portion of a Direct Consolidation Loan that may be attributable to the underlying loan to which a borrower defense is being asserted, or refers to the borrower's request for a return of payments collected by the Secretary on the underlying loan.

Direct Loans Paid Off by Direct Consolidation Loans

Applicable standard

For Direct Loans for which borrowers may be considering consolidation, the standards would differ depending on the date on which the first Direct Loan to which a claim is asserted was made. If the Direct Loan Consolidation borrower asserts a claim regarding an underlying Direct Subsidized, Unsubsidized, or PLUS Loan made before July 1, 2017, we would apply the standard in §685.206(c). For underlying Direct Loans made after July 1, 2017, we would apply the standard stated in §685.222(b), (c), or (d) to the borrower's defenses to repayment, as we would if the borrower had challenged those loans directly through the borrower defense process.

Return of payments

For underlying Direct Loans made before July 1, 2017, we would apply applicable state law as to the limitations period pursuant to §685.206(c), to any claim for return of payments made or recovered on the underlying loans or on that portion of the Direct Consolidation Loan attributable to the paying off of the underlying Direct Loan.

For underlying Direct Loans made on or after July 1, 2017, we would apply the limitations period in §685.222(b), (c), or (d), as applicable, to any claim for return of payments made or recovered on the underlying loans or on that portion of the Direct Consolidation Loan attributable to the paying off of the underlying Direct Loan.

Other Eligible Loans Paid Off by Direct Consolidation Loans

Applicable standard

For other education loans paid off by the Direct Consolidation Loan, such as FFEL, Perkins, or other eligible loans for consolidation that are not Direct Loans, the standard that will apply to a defense to repayment of an applicable portion of the outstanding balance of borrowers' Direct Consolidation Loans would depend upon the date that the Direct Consolidation Loan was made. For such defense to repayment claims raised by Direct Consolidation Loan borrowers with regard to other education loans paid off by a Direct Consolidation Loan that was made before July 1, 2017, we would evaluate the defense to repayment with respect to the underlying loan under the Direct Loan defense standard in §685.206(c), as if the challenged loan were a Direct Loan. For such a Direct Consolidation Loan made on or after July 1, 2017, we would evaluate the borrower's defense to repayment with respect to the underlying loan under the Direct Loan borrower defense standard in proposed §685.222.

Return of payments

However, for claims for return of payments made or recovered on the underlying loan, we would return only payments made or recovered by the Department directly, and only if the borrower proved that the loan or portion of the loan to which the payment was credited was not legally enforceable under the law governing the claims on the underlying, paid off loans. If the borrower seeks recovery of a payment made on the Direct Consolidation Loan itself, as distinct from payments made on the underlying paid-off loan, the applicable standard governing claims for return of payments would be that provided in §685.206(c) (for Direct Consolidation Loans made before July 1, 2017) or §685.222(b), (c), or (d) (for Direct Consolidation Loans made on or after July 1, 2017). Similarly, depending on the date that the Direct Consolidation Loan was made, the limitation periods applicable to claims for return of payments made on the Direct Consolidation Loan would be those stated in either §685.206(c) or §685.222(b), (c), or (d), accordingly.

In addition, the proposed amendment to §685.212 would not allow a borrower to assert a borrower defense more than once for a claim that is based on the same underlying circumstances and same evidence, unless allowed under the procedures in proposed §685.222. For instance, if a borrower asserted a borrower defense with respect to a loan under either §685.206(c) or proposed §685.222 that was denied in full or in part, the borrower may not then assert a borrower defense with respect to that original loan after consolidation, absent new evidence as described in proposed §685.222(e)(5) or a reopening of an application for borrower defense by the Secretary under that section.

<u>Remedial Action and Recovery from the Institution</u>

<u>General (§§685.206, 685.308)</u>

<u>Statute</u>: Section 454(a) of the HEA provides that the Secretary may include in Direct Loan participation agreements with institutions provisions that are necessary to protect the interests of the United States and to

promote the purposes of the Direct Loan Program, and that the institution accepts responsibility and financial liability stemming from its failure to perform its functions pursuant to the agreement.

Current Regulations: The current regulations provide, in §685.206(c), that the Secretary may initiate an action to recover from a school whose act or omission resulted in an approved borrower defense the amount of loss incurred by the Department for that claim, but may not do so after the end of the record retention period provided under §685.309(c), which is three years after the end of the award year in which the student last attended the institution. See §685.309, which references §668.24.

In addition, current §685.308 provides that the Secretary may take various actions to recover for losses caused by institutions, and describes the procedures that would be used for some claims.

Proposed Regulations: We propose to remove from §685.206 the provision stating that the Secretary would not initiate action to recover after the end of the three-year record retention period. We further propose to revise §685.308 to more accurately describe the instances in which the Secretary incurs a loss for which the institution is accountable.

Reasons: We propose to remove the limitation on bringing actions against an institution to recover for losses incurred from borrower defenses for two reasons. First, the current three-year limitation in §685.206(c)(3) cites §685.309(c), which refers to §668.24, the general record retention requirements for the title IV, HEA student financial assistance programs. Section 668.24(e)(2) provides that the institution is to 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 institution. The requirement pertains to the retention of "program records"--records of the determination of eligibility for Federal student financial assistance and management of Federal funds provided to the institution for those awards. §§668.24(a), 685.309.[21] The Department believes that these records will rarely, if ever, be needed to address borrower defense claims. Borrower defense claims will turn on other evidence--advertising, catalogs, enrollment contracts, recruiting scripts--that have not

[21] The record retention regulation was adopted pursuant to 20 U.S.C. 1232f, which requires each recipient of Federal funds under a Department program to keep records that disclose "the amount and disposition of those funds," and to "maintain such records for three years after the completion of the activity for which the funds are used."

been and cannot be categorized as “program records.” Moreover, institutions have always faced potential litigation on claims that would also constitute borrower defense claims, and have already made business judgments as to the need and period for which to retain business records that may be relevant in such litigation. The proposed change would do no more than hold the school to the same risk it has already assessed and for which it has exercised its business judgment to protect itself. As noted under “Federal Standard and Limitation Periods (34 CFR 685.222(b), (c), and (d) and 34 CFR 668.71),” State laws and the new proposed Federal standard generally provide that the limitation period for affirmative claims for recovery based on misrepresentation begins only upon the claimant’s discovery of the facts that give notice that the representation was false, and thus an institution would already be expected to have accounted for that potential in adopting its own record retention policies. We are not, however, proposing to impose any new requirements relating to record retention. Moreover, borrowers--whether a designated Department official assists in developing the evidence for the borrower under proposed §685.222 or not--

always bear the burden of proof, either initially or ultimately.[22] The institution thus faces potential risk where a borrower belatedly asserts a borrower defense only if the borrower--or the Department, for claims considered as a group, asserts a claim pertaining to the borrower--meets that burden by producing credible evidence of the facts on which the claim is based.

Second, the most readily available tool for recovery of Federal claims has always been administrative offset, which Federal law encourages and even requires agencies to use. 31 U.S.C. 3716. That authority was amended in 2008 to remove its previous 10-year limitation period.[23] Case law makes clear that limitations periods adopted by a legislative authority can be changed or abrogated, and the new limitation period applied even to claims that may have been barred under the prior rule.[24] Because the limitation period in current §685.206(c)(3) is solely a regulatory

[22] The rebuttable presumption applicable to group claims shifts the burden of rebuttal to the school; if the school submits evidence to rebut that presumption, the burden of proof then, and only then, shifts back to the borrower.

[23] "Notwithstanding any other provision of law, regulation, or administrative limitation, no limitation on the period within which an offset may be initiated or taken pursuant to this section [§3716] shall be effective." 31 U.S.C. 3716(e)(1).

[24] In re Lewis, 506 F.3d 927, 932 (9th Cir. 2007); U.S. v. Distefano, 279 F.3d 1241, 1244 (10th Cir. 2002) (noting that "the Supreme Court has upheld, against due process challenges, statutes reviving such barred claims. See Chase Sec. Corp. v. Donaldson, 325 U.S. 304, 311-14, 65 S.Ct. 1137, 89 L.Ed. 1628 (1945); Campbell v. Holt, 115 U.S. 620, 628, 6 S.Ct. 209, 29 L.Ed. 483 (1885). As have we. See Bernstein v. Sullivan, 914 F.2d 1395, 1400-03 (10th Cir.1990).").

limitation adopted by the Department pursuant to its regulatory authority and was in no way compelled by statute, the Department can change or remove that limitation and can apply the revised rule to any claim, without regard to when that claim arose. This would not produce an unfair result. As noted in the background discussion under "Borrower Defenses (34 CFR 668.71, 685.205, 685.206, and 685.222)," the borrower defense provision in §685.206(c) has been infrequently utilized from 1995 until the recent Corinthian experience, and there is no reason to believe that any institution would have relied on the three-year limitation period in current §685.206(c)(3) to discard business records that it would otherwise have retained.

We propose to revise §685.308 to more accurately describe the grounds on which an institution can cause loss for which the Secretary holds the school accountable, and the procedures used to establish and enforce that liability in some particular circumstances. An institution participates in the title IV, HEA programs only by entering into a program participation agreement. Under that agreement, the institution accepts responsibility to act as a fiduciary in handling, awarding, and accounting for title IV, HEA funds that it awards, and is liable for the costs of funds it fails to account for, or funds it awards or causes to be awarded improperly.[25] An institution participates in the Direct Loan Program only by entering into a Direct Loan program participation agreement.[26] Under that agreement, the institution agrees to "originate" Direct Loans that are made by the Department, and to accept financial liability for losses "stemming from" its failure to perform its functions under that agreement. The institution breaches its fiduciary duty as originator of Direct Loans when it causes a loan to be made to an individual who was ineligible to receive that loan, or causes an eligible individual to receive a loan in an

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[25] See, e.g., Nat'l Career Coll., Inc. v. Spellings, 371 F. App'x 794, 796 (9th Cir. 2010) (college has fiduciary duties in handling the public's money. 34 CFR 668.15, 668.16, 668.82); Sistema Universitario Ana G. Mendez v. Riley, 234 F.3d 772, 775 (1st Cir. 2000)(As a result of fiduciary status, institutions bear burden of proving that their expenditures of title IV funds were warranted and that they complied with program requirements); St. Louis Univ. v. Duncan, 97 F. Supp. 3d 1106, 1109 (E.D. Mo. 2015) (institution acts as fiduciary and is liable for improperly awarded funds); Maxwell v. New York Univ., No. 08 CV 3583 (HB), 2009 WL 1576295, at *7 (S.D.N.Y. June 1, 2009), aff'd, 407 F. App'x 524 (2d Cir. 2010) (school acts as a fiduciary for the Department); Instituto De Educ. Universal, Inc. v. U.S. Dep't of Educ., 341 F. Supp. 2d 74, 82 (D.P.R. 2004), aff'd sub nom. Ruiz-Rivera v. U.S. Dep't of Educ., No. 05-1775, 2006 WL 1343431 (1st Cir. May 10, 2006), and subsequently aff'd sub nom. Instituto de Educacion Universal v. U.S. Dep't of Educ., No. 06-1562, 2007 WL 1519059 (1st Cir. May 11, 2007) (Under HEA, an educational institution operates as a fiduciary to the Department, and is subject to the highest standard of care and diligence in administering these programs and accounting to the Department for the funds it receives. 34 CFR 668.82(a), (b) (1991–94)); see also Chauffeur's Training Sch., Inc. v. Riley, 967 F. Supp. 719, 727 (N.D.N.Y. 1997) (institution liable under breach of contract for costs of payments the Department made to third parties on account of loans the institution improperly caused to be made).

[26] This Direct Loan Program Participation Agreement is now included in, and a separate part of, the general program participation agreement required by section 487(a) of the HEA.

ineligible amount, or by its act or omission causes the Secretary to incur an obligation to discharge a loan or to be unable to enforce the loan.

We propose to revise §685.308 to more accurately describe the range of these circumstances. In some instances, the Secretary identifies possible claims for Department losses for which the Secretary holds the school accountable in audits and program reviews, and if such claims are asserted in the final determinations that ensue from these audits or program reviews, the institution may contest the claims under the procedures in subpart H of part 668. In other instances, the Secretary asserts these claims in other contexts, and may follow other procedures to claim recovery. In any such other procedure, Federal law and Department regulations require the Secretary to provide the institution notice and an opportunity to dispute the claim and obtain a hearing on its objections. See 34 CFR 34.20 et seq. For borrower defense claims, we describe briefly in proposed §685.222 the procedures we propose to use for these claims and intend to prescribe them in more detail in the future.

We also propose to remove the reference to a remedial action (requiring schools to purchase loans) that was sanctioned under FFEL regulations in effect when this section was adopted in 1995, but which has not and will not be used for Direct Loans.

Severability (§685.223)

Statute: Section 454(a) of the HEA provides that the Secretary may include in Direct Loan participation agreements with institutions provisions that are necessary to protect the interests of the United States and to promote the purposes of the Direct Loan Program; 20 U.S.C. 3474 authorizes the Secretary to adopt such regulations as needed for the proper administration of programs.

Current Regulations: None.

Proposed Regulations: Proposed §685.223 would make clear that, if any part of the proposed regulations for part 685, subpart B, whether an individual section or language within a section, is held invalid by a court, the remainder would still be in effect.

Reasons: We believe that each of the proposed provisions discussed in this preamble would serve one or more important, related, but distinct, purposes. Each provision would provide a distinct value to students, prospective students, and their families, the public, taxpayers, the Federal government, and institutions separate from, and in addition to, the value provided by the other provisions. To best serve these purposes, we propose to include this administrative provision in the regulations to make clear that the regulations are designed to operate independently of each other and to convey the Department's intent that the potential invalidity of one provision should not affect the remainder of the provisions.

Institutional Accountability

Financial responsibility

General (§668.171)

Statute: Section 487(c)(1) 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 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 for-profit institution is financially responsible if it satisfies the ratio requirements and other criteria specified in the general standards under §668.171(b). Under those standards, an institution:

- Must have a composite score (combining the named measures of financial health elements to yield a single measure of a school’s overall financial health) 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 are not proposing any changes to the composite score requirements under §668.172 or in appendices A and B of subpart L, the refund reserve standards under §668.73, or the past performance requirements under §668.174.

We propose to restructure §668.171, in part, by adding a new paragraph (c) that provides that an institution is not able to meet its financial or administrative obligations if it is subject to one or more of the following actions or triggering events:

- Any of the following lawsuits and other actions.

Claims and actions related to a Federal loan or educational services. Currently or at any time during the three most recently completed award years, the institution is or was required to pay a material amount, or incurs a material liability, arising from an investigation or similar action initiated by a State, Federal, or other oversight entity, or settles or resolves for a material amount a suit by that entity based on claims related to the making of a Federal loan or the provision of educational services. An amount paid or settled is material if it exceeds the lesser of the threshold amount for which an audit is required under 2 CFR part 200, currently $750,000, or 10 percent of the institution's current assets. Or, the institution is being sued by one or more State, Federal, or other oversight entities based on claims related to the making of a Federal loan or provision of educational services for an amount that exceeds the lesser of the threshold amount for which an audit is required under 2 CFR part 200, currently $750,000, or 10 percent of the institution's current assets.

Claims of any kind. The institution is currently being sued by one or more State, Federal, or other oversight entities based on claims of any kind that are not related to a Federal loan or educational services, and the potential monetary sanctions or damages from that suit or suits are in an amount that exceeds 10 percent of its current assets.

False claims and suits by private parties. The institution is currently being sued in a lawsuit filed under the False Claims Act or by one or more private parties for claims that relate to the making of loans to students for enrollment at the institution or the provision of educational services if that suit (1) has survived a motion for summary judgment by the institution and has not been dismissed, and (2) seeks relief in an amount that exceeds 10 percent of the institution's current assets.

For suits relating to claims of any kind, suits filed under the False Claims Act, 31 U.S.C. 3729 et seq., or suits by private parties, during the fiscal year for which the institution has not yet submitted its financial statements, the institution settled or resolved the suit, had a judgment entered against it, or incurred a liability for an amount that exceeds 10 percent of its current assets.

An institution would determine whether any of these suits or actions exceeded a materiality threshold by using the current assets reported in its most recent audited financial statements submitted to the Department. Except for a suit by private parties, if a suit or action does not demand a specific amount of relief, the institution would calculate the potential amount of the relief by totaling the tuition and fees it received from every student who attended the institution during the period for which the relief is sought. In cases where no period is stated in the suit or action, the institution would total the tuition and fees it received from students who attended the institution during the three award years preceding the date that suit or action was filed or initiated.

- Repayments to the Secretary. Currently or at any time during the three most recently completed award years, the institution is or was required to repay the Secretary for losses from borrower defense claims in an amount that, for one or more of those years, exceeds the lesser of the threshold amount for which an audit is required under 2 CFR 200, currently $750,000, or 10 percent of the institution's current assets, as reported in the most recent audited financial statements.

- Accrediting agency actions. Currently or at any time during the three most recently completed award years, the institution's primary accrediting agency (1) required the institution to submit a teach-out plan, for a reason described in 34 CFR 602.24(c)(1), that covers the institution or any of its branches or additional locations, or (2) placed the institution on probation, show-cause, or similar status for failing to meet one or more of the agency's standards, and the accrediting agency does not notify the Secretary within six months of taking that action that the action is withdrawn because the institution has come into compliance with the agency's standards.

- Loan agreements and obligations. With regard to the creditor with the largest secured extension of credit , (1) the institution violated a provision or requirement in a loan agreement with that creditor, (2) the institution failed to make a payment in accordance with its debt obligations with that creditor for more than 120 days, or (3) as provided under the terms of the security or loan agreement, a default or delinquency event occurs or other events occur that trigger, or enable the creditor to require or impose, an increase in collateral, a change in contractual obligations, an increase in interest rates or payments, or other sanction penalty or fee. These actions would be disclosed in a note to the institution's audited financial statements or audit opinion, or reported to the Department by the institution.

- Non-title IV revenue. 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) (90/10 revenue test).

- Publicly traded institutions. As reported by the institution, or identified by the Secretary, (1) the Securities and Exchange Commission (SEC) warns the institution or its corporate parent that it may suspend trading on the institution's stock, or the institution's stock is delisted involuntarily from the exchange on which the stock was traded, (2) the institution disclosed or was required to disclose in a report filed with the SEC a judicial or administrative proceeding stemming from a complaint filed by a person or entity that is not part of a State or Federal action, (3) the institution failed to file timely a required annual or quarterly report with the SEC, or (4) the exchange on which the institution's stock is traded notifies the institution that it is not in compliance with exchange requirements.

- Gainful employment (GE). As determined by the Secretary each year, the number of students enrolled in GE programs that are failing or in the zone under the D/E rates measure in §668.403(c) is more than 50 percent of the total number of title IV recipients enrolled in all the GE programs at the institution. However, an institution is exempt from this provision if fewer than 50 percent of students enrolled at the institution who receive title IV, HEA program funds are enrolled in GE programs.
- Withdrawal of owner's equity. For an institution whose composite score is less than 1.5, any withdrawal of owner's equity from the institution by any means, including by declaring a dividend.
- Cohort default rates. The institution's two most recent official cohort default rates are 30 percent or greater, as determined under subpart N of 34 CFR part 668. However, this provision does not apply if the institution files a challenge, request for adjustment, or appeal under that subpart with regard to its cohort default rate, and that action results in (1) reducing its default rate below 30 percent, or (2) the institution not losing its eligibility or being placed on provisional certification.
- Other events or conditions. The Secretary determines that an event or condition is reasonably

likely to have an adverse impact on the financial condition, business, or results of operations of the institution. These events or conditions would include but are not limited to whether:

- There is a significant fluctuation between consecutive award years , or over a period of award years, in the amount of Direct Loan or Pell Grant funds, or a combination of those funds, received by the institution that cannot be accounted for by changes in those programs, such as changes in award amounts or eligibility requirements;
- The institution is cited by a State licensing or authorizing agency for failing State or agency requirements;
- The institution fails a financial stress test developed or adopted by the Secretary to evaluate whether the institution has sufficient resources to absorb losses that may be incurred as a result of adverse conditions and continue to meet its financial obligations to the Secretary and students;
- The institution or corporate parent has a non-investment grade bond or credit rating;
- As calculated by the Secretary, the institution has high annual dropout rates; or

- Any event reported on a Form 8-K to the SEC.

In addition, we propose to add a new paragraph (d) under which an institution would notify the Secretary of any action or triggering event described above no later than 10 days after that action or event occurs. In that notice, the institution could show that certain actions or events are not material, or that those actions are resolved. Specifically, the institution would be permitted to demonstrate that:

- For a judicial or administrative proceeding the institution disclosed to the SEC, the proceeding does not constitute a material event;

- For a withdrawal of owner's equity, the withdrawal was used solely to meet tax liabilities of the institution or its owners for income derived from the institution; or, in the case where the composite score is calculated based on the consolidated financial statements of a group of institutions, the amount withdrawn from one institution in the group was transferred to another entity within that group;

- For a violation of a loan agreement, the creditor waived that violation. However, if the creditor imposes additional constraints or requirements as a condition of waiving the violation and continuing with the loan, the institution must identify and describe those constraints or requirements. In addition, if a default or delinquency event occurs or other events occur that trigger, or enable the creditor to require or impose, additional constraints or penalties on the institution, the institution would be permitted to show why these actions would not have an adverse financial impact on the institution.

Reasons: As discussed under "Alternative standards and requirements," the Department seeks to identify, and take action regarding, material actions and events that are likely to have an adverse impact on the financial condition or operations of an institution. In addition to the current process where, for the most part, the Department determines annually whether an institution is financially responsible based on its audited financial statements, under these proposed regulations the Department may determine at the time a material action or event occurs that the institution is not financially responsible. The consequences of these actions and events threaten an institution's ability to (1) meet its current and future financial obligations, (2) continue as a going concern or continue to participate in the title IV, HEA programs, and (3) continue to deliver educational services. In addition, these actions and events call into question the institution's ability or commitment to provide the necessary resources to comply with title IV, HEA requirements.

Furthermore, we note that recent experiences with Corinthian, in which the Department ended up with no financial protection for either closed school or borrower defense claims, highlight the need to develop more effective ways to identify events or conditions that signal impending financial problems and secure financial protection while the institution has resources sufficient to provide that protection either by a letter of credit, or, by arranging a set-aside from current payables of Federal funds that could defray losses that may arise. Applying the routine tests under current regulations did not result in financial protection, because Corinthian appeared at the time it provided the Department with its audited financial statements to pass those tests. Only later--too late to secure financial protection--did further investigation reveal that Corinthian in fact had failed the financial tests in current regulations.[27] Based on that experience, we conclude that regulations must be revised to better identify signs, and to augment the Department's tools for detection, of impending financial difficulties that could be taken into account and that would have required Corinthian to provide financial protection.

Most visible among these actions or triggering events are investigations of, and suits against, institutions by State, Federal, and other oversight agencies. For example, the FTC has investigated or filed suit against institutions for deceptive and unfair marketing practices.[28] The SEC has investigated institutions for inflating job placement rates.[29] The DOJ, CFPB, and various State AGs have investigated or filed suit against institutions for making false claims to the Federal and State governments as well as violations of consumer protection laws, false advertising and deceptive practices, and falsifying job placement rates.[30] Putting aside, but in no way

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[27] At that very time, in 2013, the State of California had already sued Corinthian for widespread fraud. California v. Heald Coll., No. CGC-13-534793 (Sup. Ct. S.F. County, filed Oct. 10, 2013).

[28] See, e.g., Fed. Trade Comm'n v. DeVry Educ. Group, Inc., C.A. No. 15-CF-00758 (S.D. Ind. Filed Jan. 17, 2016).

[29] See, e.g., Sec. and Exch. Comm'n v. ITT Educ. Servs. Inc., C. A. No. 1:15-cv-00758-JMS-MJD (S.D. Ind. filed May 12, 2015).

[30] See, e.g., U.S. et al. ex rel. Washington v. Educ. Mgmt. Corp., C.A. No. 2:07-cv-00461-TFM (W.D. Pa. filed Aug. 8, 2011); Consumer Fin. Prot. Bureau v. Corinthian Colls., Inc., C.A. No. 1:14-cv-07194 (N.D.

diminishing, the harm inflicted on students by troubling practices that precipitated these agency actions, the debts or liabilities resulting from those actions may be substantial.

For suits that are settled or investigations that are otherwise resolved, we initially proposed during negotiated rulemaking to adopt as materiality thresholds those amounts included in the SEC disclosure rules for legal proceedings under 17 CFR 229.103, otherwise referred to as Item 103 of Regulation S-K. Under those regulations, an entity filing an annual or quarterly report on Form 10-K or 10-Q with the SEC must disclose information about (1) any administrative or judicial proceeding that involves a claim for damages that exceeds 10 percent of the entity's current assets, or (2) any environmental claim where a governmental authority is a party to the proceeding and the monetary sanctions are more than $100,000.

Some of the non-Federal negotiators argued that the $100,000 threshold could easily be exceeded by claims resolved in favor of a small number of students, and that outcome would have no bearing on the financial operations of most institutions. Those negotiators suggested that a

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Ill., filed Oct. 27, 2015); California v. Heald Coll., No. CGC-13-534793 (Sup. Ct. S.F. County, filed Oct. 10, 2013).

more reasonable threshold would be the amount applicable to audits required of non-profit and public entities that expend Federal funds. Under 2 CFR 200.501 of the Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards (Uniform Administrative Requirements), a non-Federal entity that expends more than $750,000 in Federal funds during its fiscal year must conduct an audit. We agreed, and propose in this NPRM to set the dollar threshold at the amount specified in the Uniform Administrative Requirements.

The non-Federal negotiators also argued that because the dollar threshold and the percentage threshold based on SEC disclosure requirements would apply to a suit based on claims that were not related to a Federal student aid activity or requirement (for example, a violation of copyright laws), the Federal protection that would otherwise be required under this circumstance is not warranted. We agreed, and propose in this NPRM to apply the dollar and percentage thresholds to those suits or actions that are based on claims related to the making of a Federal loan or the provision of educational services.

The publicity and information stemming from these suits and actions will make members of the public, and in particular currently enrolled and former students of the institution, aware or more aware of the alleged practices that gave rise to these suits and actions. As a result, we expect current and former students to be better informed and thus more likely to file borrower defense claims. Some students may file claims immediately after a suit or action is resolved, while others may take longer. In any case, because the institution is required to repay the Secretary for losses from borrower defense claims, the institution's liability does not end when it pays to resolve the suit or action; it continues as long as students file borrower defense claims based on the misconduct alleged and publicized in the suit. Consequently, if the amount paid by an institution to resolve the suit is material, it jeopardizes the institution's ability to meet not only its current financial obligations, but also future financial obligations stemming from borrower defense claims. For this reason, we propose that an institution is not financially responsible during the three-year period following the resolution if the amount the institution is required to pay is material--that is, it exceeds the lesser of the dollar or percentage thresholds. If the amount is not material, we believe it is unlikely that any resulting borrower defense claims will have an adverse impact on the institution.

For a suit or action initiated by a State, Federal, or other oversight agency, or by an individual or relator,[31] where the potential monetary sanctions or damages sought exceed 10 percent of an institution's current assets, we propose that the institution is not considered to be financially responsible for any year in which that suit or action is pending or unresolved.[32]

Like a contingent liability, a pending material government or individual action (one seeking an amount greater than 10 percent of current assets) would pose a threat to an institution's ability to meet its current financial obligations, because when a suit or action is settled or resolved, the institution must satisfy the resulting liability using current assets. In other words, a significant amount of current assets (cash and liquid assets, such as securities and accounts receivable, that can readily be converted to cash) that an institution would otherwise need to use to pay for typical current liabilities (for instance, wages payable and accounts payable) would be used instead to pay for damages stemming from the suit. However, for several reasons, we

[31] A person may bring a suit under the False Claims Act, 31 U.S.C. 3729 et seq., on behalf of the United States against a party whom the relator claims submitted false claims to the government. The suit is referred to as a "qui tam" suit, and the person is referred to as a "relator."

[32] A party who submits false claims may be liable under the False Claims Act for treble the actual amount of the claim plus a penalty of at least $5000 per violation. 31 U.S.C. 3729(a)(1)

propose to treat a pending material State, Federal, or individual action as a liability for filed against the institution. First, as previously noted in this discussion, State and Federal suits and actions aim to address serious violations and harmful practices and may lead to settlements or compensation for victimized students, with an attendant financial burden on the institution. Moreover, it is not uncommon for several State AGs to file suits or take actions against an institution for the same or similar reasons or for State AGs to join a Federal action. These combined efforts underscore the severity and magnitude of the misconduct the suits or actions seek to address. Second, the impact of a suit or action may hinder or prevent investors or creditors from providing needed funds to an institution and make it more expensive for the institution to raise or obtain additional funds. Also, to protect their investment or stake in the institution, creditors may condition or alter the terms of existing loan agreements or otherwise make it more difficult for the institution to obtain additional loans. Third, the institution will have to use or divert resources that would otherwise be used to carry out normal operations to defray the costs of defending the litigation or the costs of achieving compliance with the State or Federal requirements on which the actions were based. In addition, it is not uncommon for the

Department to impose additional administrative requirements on an institution subject to a suit or action, which may further stress the institution's financial resources. So, due to the severity and likely success of suits by State and Federal agencies or other oversight entities, and to account for the costs and risks stemming from a pending suit, we believe that a potential liability in the amount considered material under this proposed regulation would threaten an institution's ability to meet its current and future financial obligations.

With regard to the threshold relating to current assets, we note that on May 9, 1973, the SEC published final regulations reducing its threshold for disclosures relating to legal proceedings from 15 percent to 10 percent of current assets, stating that the reduced percentage is a "more realistic test of materiality." 38 FR 12100, 121**01**

We are not proposing any changes to the composite score requirements under §668.172 or in appendices A and B of subpart L, the refund reserve standards under §668.73, or the past performance requirements under §668.174. We believe that the current financial ratio regulations in subpart L of part 668 reflect the kind of consideration of the effect of the financial risks that judgments and other actions pose on the ability of an institution to continue operating if faced with the need to satisfy such claims.

We therefore include a brief explanation of the way this has been taken into account to some extent in the current regulations. For title IV purposes, KPMG Peat Marwick developed the composite score methodology that is the key element for establishing the financial responsibility requirements under 34 CFR part 668, subpart L. That methodology uses three ratios, Primary Reserve, Equity, and Net Income, to evaluate the overall financial health of an institution. Under this methodology, strength factors based on a common scale are assigned to each ratio result, making it arithmetically possible to weight and add the results of each ratio together to arrive at a composite score. The strength factors and weights were designed to reflect the different governing, mission, and operating characteristics of for-profit and non-profit institutions, and to allow institutions to offset a poor performance under one ratio with a good performance under another ratio.

The first of these ratios, the Primary Reserve ratio is a measure of an institution's expendable or liquid resource base in relation to its operating size, so it is in effect a measure of the institution's margin against adversity. A for-profit institution with a Primary Reserve ratio of 0.05 earns a strength factor of 1.0 which means that the value of the institution's assets that can be converted to cash exceeds its liabilities by an amount equal to five percent of its total expenses. Expressed in days, the institution could continue operations at its current level for about 18 days (5 percent of 365 days) without additional revenue or support. 62 FR 62854 (November 25, 1997). A non-profit institution with the same strength factor score could continue operations at its current level for about 37 days without additional revenue or support. Id. At this strength factor level, institutions have a small amount of expendable capital and would have difficulty finding resources internally to handle large negative economic events. Table 1 below shows, for a range of Primary Reserve ratio results, the margin against adversity expressed both as percentage of expendable assets that exceed liabilities and the number of days an institution can continue operations.

Table 1

For-profit Institutions

Primary Reserve ratio result	Liquid assets exceed liabilities, as % of total expenses	Strength factor	Survive without additional support, # of days
0.00	0%	0	0
0.25	3%	0.5	9
0.50	5%	1	18
0.75	8%	1.5	27

0.100	**10%**	**2**	**37**
0.125	13%	2.5	46
0.150	15%	3	55

Non-profit Institutions

0.00	0%	0	0
0.05	5%	0.5	18
0.10	**10%**	**1**	**37**
0.15	15%	1.5	55
0.20	20%	2	73
0.25	25%	2.5	91
0.30	30%	3	110

As illustrated in Table 1, a for-profit institution with a Primary Reserve strength factor of less than 2.0, or a non-profit institution with a strength factor of less than 1.0, would generally not have resources that it could liquidate in the short term to cover current operations if it also had to pay damages or settle a suit for an amount that exceeds 10 percent of its expendable assets. However, the institution may have the ability to borrow the funds needed to cover operations and pay damages stemming from a suit. For that, we look to another component of the composite score, the Equity ratio.

The Equity ratio measures the amount of total resources that is financed by owners or the institution's investments, contributions, or accumulated earnings and how much of that amount is subject to claims of third parties. So, the Equity ratio captures an institution's overall capitalization structure and ability to borrow. The strength factors for the Equity ratio are the same for non-profit and for-profit institutions. A strength factor of zero means that that value of an institution's assets is equal to the value of its liabilities. For a for-profit institution, the absence of equity provides no evidence of owner commitment to the business because there are no accumulated earnings or invested amounts beyond the liabilities that are at risk. For a non-profit institution, the absence indicates there is little or no permanent endowment from which the institution could draw in extreme circumstances. At a strength factor of 1.0, an institution has about $8.33 of liabilities for every $10.00 of assets. However, this small amount of equity still makes it difficult for the institution to borrow significant amounts of money at market rates. For a strength factor of 2.0, the institution has about $6.67 of liabilities for every $10.00 of assets. At this strength factor and higher levels where an increasing proportion of the institution's resources are not subject to claims of third parties, it is more likely that the institution will be able to borrow significant amounts of money at market rates.

The remaining ratio, Net Income, is a primary indicator of the underlying causes of a change in an institution's financial condition because it directly affects the resources reflected on the institution's balance sheet (continued gains and losses measured by the ratio will impact all other fundamental elements of financial health over time). This ratio helps to answer the question of whether an institution "operated within its means" during its most recent fiscal year. A strength factor of 1.0 for the Net Income ratio means that an institution broke even for the year--it did not incur operating losses or add to its wealth with operating gains or surpluses. In other words, the institution was able to cover its cash and non-cash expenses for the year, but no more. As the strength factor increases, the wealth and surpluses added by operating gains help to increase an institution's margin against adversity.

An institution is financially responsible under the composite score methodology if, after weighting, the strength factors for all of the ratios sum to a score that is at least 1.5. For a for-profit institution, the weighting for each ratio is fairly equal--30 percent of the score is based on the Primary Reserve ratio, 40 percent on the Equity ratio, and 30 percent on the Net Income ratio. For a non-profit institution the weighting places less emphasis on the Net Income ratio at 20 percent, with the Primary Reserve and Equity ratios at 40 percent each. As noted previously, the weighting reflects the importance or significance of the operating characteristics in the two sectors.

In summary, a low strength factor for any of the three ratios indicates that an institution has little or no margin against adversity, and may not have the resources necessary to meet its operating needs. As one or more of the strength factors increase to 2.0 and above, the institution’s margin against adversity improves through a combination of increases in expendable assets, equity, or operating gains. After accounting for the importance of each of the ratios, the composite score provides an overall measure of the financial health of an institution.

However, as shown in Table 1, the methodology contemplates that an institution should have expendable assets that exceed liabilities by at least 10 percent to earn a strength factor (1.0 for an non-profit, and 2.0 for a for-profit) for the Primary Reserve ratio that provides for a margin against adversity in keeping with the minimum passing composite score of 1.5. While a good performance under the Equity ratio may help an institution obtain resources to meet its operating and contingency needs, or a good performance under the Net Income ratio may increase its wealth over time, the expendable assets reflected in the Primary Reserve ratio, which represents 30 percent to 40 percent of the composite score, are the first line of defense in dealing with an adverse situation, such as a lawsuit. That is, an institution would first seek to pay damages resulting from the suit out of expendable assets or current assets as they are referred to under the comparable SEC materiality threshold. Either way, paying damages out of liquid assets for an amount above 10 percent of expendable or current assets is likely to have an adverse impact on an institution's ability to meet its current and future financial obligations, particularly if the institution has little or no liquid assets.

With regard to a suit that is based on claims other than the making of a Federal loan or the provision of educational services, while that suit is pending an institution would not be financially responsible. If the institution settles or otherwise resolves that suit for an amount that exceeds 10 percent of its current assets, the institution would still not be considered financially responsible until it submits audited financial statements that cover the fiscal year in which the suit was settled or resolved. At that point, the Department would be able to evaluate the impact of the suit through the calculation of the institution's composite score. So, until the Department calculates the institution's composite score, the institution would be treated as if the suit was still pending.

In cases where a suit or action does not demand a specific amount as relief, we could allow an institution to estimate and use that amount in determining whether the suit or action would exceed the materiality thresholds. However, doing so would lead to inconsistent and widely differing estimates among institutions, or more concerning, estimates significantly lower than the potential damages. Consequently, we propose a uniform approach under which the estimates are based on the total amount of tuition and fees received by the institution for students enrolled at the institution during the period for which the relief is sought. If no period is stated, an institution would estimate the amount based on the total amount of tuition and fees received by the institution for the three award years preceding the date the suit or action was filed or initiated. However, we do not believe this approach is appropriate for private party actions that do not demand a specific amount of relief because the reasons for those actions may impact a more limited group of students. We seek comment on this approach and on other approaches that provide a reasonable way to estimate the potential damages from suits and other actions.

With regard to repayments to the Secretary for losses to the Secretary from resolved borrower defense claims, an institution's ability to meet its current and future financial obligations is threatened whenever repayments for those losses rise to levels above the materiality thresholds, regardless of whether those repayments are related to or otherwise stem from the factual findings and theories resulting from an investigation or lawsuit initiated by the Department, a State or Federal agency, oversight entity, or some other party. Therefore, we propose to apply the dollar and percentage materiality thresholds to this triggering event.

To provide background on the proposed trigger relating to a teach-out plan, under 34 CFR 602.24(c)(1), an accrediting agency requires an institution to submit a teach-out plan whenever (1) the Secretary takes an emergency action or initiates a proceeding to limit, suspend, or terminate the institution's participation in the title IV, HEA programs, (2) the agency acts to withdraw, terminate, or suspend the accreditation or pre-accreditation of the institution, (3) the institution notifies the agency that it intends to cease operations entirely or close a location that provides 100 percent of at least one program, or (4) a State licensing or authorizing agency notifies the accrediting agency that it has or will revoke the institution's license or legal authorization to provide an educational program. Except for the closure of small locations, these actions jeopardize the institution's participation in the title IV, HEA programs. During the negotiated rulemaking sessions, some of the non-Federal negotiators noted that an institution may close a location that only a few students attended. In that case, the negotiators argued that some materiality threshold should apply because that closure would probably not have an adverse impact on the institution. Although those negotiators did not propose any specific thresholds, they suggested that thresholds based on the number of students enrolled or affected by the closure, or a dollar amount associated with those students, would be appropriate. We seek comment on whether the Department should adopt a threshold for this circumstance, and specifically seek comment on what that threshold should be.

With regard to a situation where an accrediting agency places an institution on probation, issues a show-cause order, or places an institution in a similar status, we view that action as calling into question the institution's ability to continue to provide educational services, and it may be a precursor to losing accreditation. Some of the non-Federal negotiators argued that because an institution may be placed on probation for a minor infraction or for a reason that could be readily resolved, the Department should not determine, or at least not determine immediately, that the institution is not financially responsible. In response, we suggested, and are proposing in this NPRM, that the Department would wait six months before making a determination to provide adequate time for an institution with a minor infraction to come into compliance with its accrediting agency standards. We also suggested during the negotiating sessions that we could accept an accrediting agency determination that an institution’s failure to comply with agency standards within a six-month timeframe has not had and is not expected to have a material adverse financial impact on the institution, and that the agency anticipates the institution will come into compliance within a longer time frame set by the agency under 34 CFR 602.20. However, some of the non-Federal negotiators believed that an accrediting agency could not make this determination or make predictions about future compliance by an institution. We seek comment about whether or how we should provide a way for an accrediting agency to inform the Department why its action of placing an institution on probation will not have an adverse impact on the institution’s financial or operating condition.

With regard to the triggers on loan agreements and obligations, some of the non-Federal negotiators believed that it was inappropriate to conclude that an institution is not financially responsible if it violates any loan agreement or fails to make a payment on a loan, regardless of the amount of or purpose for the loan or whether the loan was collateralized. In response we suggested, and are proposing in this NPRM, to apply this trigger when an institution violates a loan agreement with, or as currently provided under §668.171(b)(3)(ii), fails to make a payment for more than 120 days to, the creditor with the largest secured extension of credit to the institution. We believe this proposal addresses the materiality concerns raised by the negotiators and speaks directly to an institution's ability to meet its current financial obligations. However, the creditor may impose penalties or more restrictive requirements on the institution under the terms of its security or loan agreements that call into question the institution's ability to meet its current and future financial obligations. The Department is particularly concerned about identifying events in which the institution displays early indications of financial difficulty, and taking appropriate precautions as early as possible to protect the taxpayer. Lenders and creditors that provide financing to an institution under security and loan agreements typically monitor the institution's financial performance to ensure that it satisfies the loan requirements and are thus in the best position to identify contemporaneously any risks or problems that may hinder or prevent the institution from doing so. If these risks or problems arise, the creditor may impose penalties and additional restrictions on the institution, including increasing collateral or compensating balance requirements. For this reason, we propose to treat the imposition of penalties and additional requirements in loan agreements as a triggering event but, under the reporting requirements in proposed paragraph (d), we will allow the institution to demonstrate that these actions by the creditor will not have adverse impact on the institution.

With regard to the 90/10 revenue test, a for-profit institution that fails the test for a 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. Therefore, we believe this is an appropriate trigger to include.

For a publicly traded institution, we are proposing as triggers four SEC-related actions that jeopardize the institution's ability to meet its financial obligations or continue as a going concern. First, we propose as a trigger an SEC warning to the institution that it may suspend trading on the institution's stock and take other action regarding the registration status of the company, pursuant to section 12(k) of the Securities Exchange Act, 15 U.S.C. 78l(k). 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.[33] In that event, the SEC posts the suspension and the grounds for the suspension on its Web site. However, under the reporting requirements in proposed §668.171(d), the institution would be required to notify the Department within 10 days of receiving such a warning from the SEC. The SEC may decide to 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

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

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.[34]

Second we propose that whenever the exchange on which the institution's stock is traded notifies the institution that it is not in compliance with exchange requirements, that notice is a triggering event. 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.[35] If a stock falls below the minimum price, other requirements are not met, or the institution fails to provide timely reports of its performance and operations in its Form 10-Q or 10-K filings with the SEC, the exchange may delist the institution's stock. Delisting is generally regarded as the first step toward Chapter 11 bankruptcy.

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[34] Id.

[35] 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 http://nysemanual.nyse.com/lcm/sections/lcm-sections/chp_1_9/default.asp.

However, before the exchange initiates a process to delist the stock, it notifies the institution and gives it several days to respond with a plan of the actions it intends to take to come into compliance with exchange requirements.

Third, as proposed, if an institution discloses or is required to disclose in a report filed with the SEC a judicial or administrative proceeding stemming from a complaint filed by a person or entity that is not part of a State or Federal action, that would be a triggering event. SEC rules require the institution to disclose litigation that is material within the context of its disclosure obligations to investors. 17 CFR 229.103. We recognize that publicly traded institutions may, to comply unequivocally with this obligation, report litigation that they would not otherwise consider to be a material adverse event. As noted in the description of these proposed regulations above, an institution that makes such a disclosure of litigation in an SEC filing may explain in reporting that disclosure to the Department why that litigation or suit does not constitute a material adverse event that would pose an actual risk to its financial health.

Fourth, we propose to add as a trigger the institution’s failure to file timely a required annual or quarterly report with the SEC. As noted previously in this discussion, the late filing of, or failure to file, a required SEC report may precipitate an adverse action by the SEC or a stock exchange. We seek comment on how we could more narrowly tailor these proposed triggers for publicly traded institutions to capture only those circumstances that could pose a risk to the institution’s financial health.

The proposed GE trigger would apply to an institution at which the majority of its students who receive title IV, HEA assistance are enrolled in GE programs, and the majority of those GE students enroll in failing and zone programs. Since failing and zone programs are in danger of losing the title IV, HEA eligibility, the corresponding loss of revenue from those programs may jeopardize the institution’s ability to continue as a going concern. In addition, because most of the GE students are enrolled in programs that have not enabled former graduates to earn enough to afford to pay their student loans, we question the institution’s ability to provide adequate educational services. We seek comment on whether the majority of students that enroll in zone or failing GE programs is an appropriate threshold or whether and why we should adopt a different threshold.

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 and propose in this NPRM to relocate this provision to the general standards of financial responsibility under §668.171. Under the general standards, this provision would become a trigger 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 or its continued participation in the title IV, HEA programs. However, as noted in the discussion of these proposed regulations above, an institution may show that the withdrawal of funds was for a legitimate purpose or that it has no impact on the institution's composite score.

With regard to the trigger for an institution whose cohort default rate is 30 percent or more for two consecutive years, the institution is in danger of losing its program eligibility in the subsequent year if its cohort default rate is again 30 percent or more.

However, if the institution files a challenge, request for adjustment, or appeal under subpart N, we propose to wait until that challenge, request, or appeal is resolved before determining whether the institution violated the trigger. However, we seek comment on whether this trigger should apply to an institution whose cohort default rate is 30 percent or more for any one year because, under that circumstance, the institution is required by statute to develop a default prevention plan and submit it to the Secretary, indicating that Congress recognized the risk that such an institution could pose to borrowers and taxpayers and therefore warranted a plan for remediation after a single year of low performance.

As discussed during the negotiated rulemaking sessions, all of these actions and events would serve as "automatic triggers," meaning that an institution would not be financially responsible for at least one year based solely on the occurrence of that action or event, or for the triggers relating to an action by a State, Federal, or other oversight entity, including an accrediting agency, would not be financially responsible for a period of three years after an action by that agency. During negotiated rulemaking we also discussed, and we have proposed in this NPRM, other factors or conditions that the Secretary could consider in determining whether an institution is financially responsible. These factors and conditions, which we refer to as “discretionary triggers,” are factors or conditions that could be reasonably likely to have an adverse impact on the financial condition, business, or results of operations of a particular institution. If the Secretary determines that any of these factors alone or in combination calls into question the financial capability of an institution, the Secretary notifies the institution of the reasons for that determination.

Two of the discretionary triggers, fluctuations in Direct Loan and Pell Grant funds and high dropout rates, stem from the statutory provisions for selecting institutions for program reviews in section 498a(a) of the HEA. 20 U.S.C. 1099c-1(a). Significant increases or decreases in the volume of Federal funds may signal rapid expansion or contraction of an institution’s operations that may either cause or be driven by negative turns in the institution’s financial condition or its ability to provide educational services. Similarly, high dropout rates may signal that an institution is employing high-pressure sales tactics or is not providing adequate educational services, either of which may indicate financial difficulties and result in enrolling students who will not benefit from the training offered and will drop out, leading to financial hardship and borrower defense claims.

Another discretionary trigger deals with the oversight activities of a State authorizing or licensing agency, where a failure by an institution to comply with agency requirements could jeopardize its ability to operate, or provide educational programs, in that State.

Some non-Federal negotiators expressed support for the proposed use of a financial stress test that would be developed or adopted by the Department. Under the test, we would be able to assess or model an institution's ability to deal with an economic crisis or other adverse conditions. Like the composite score, the stress test could be used to assess whether, or to augment an analysis of whether, an institution is able to meet its financial obligations to students and the Secretary. An institution's bond or credit rating could be used in a similar way. During negotiated rulemaking we proposed, and propose in this NPRM, that an institution with a non-investment grade bond or credit rating[36] could be subject to additional scrutiny because any rating below investment grade indicates that the institution is likely to default on the debt for which that rating is issued.

The last discretionary trigger, any event reported by an institution to the SEC on a Form 8-K, is intended to capture events that are not included in the automatic triggers but may nevertheless have a significant adverse impact on business operations. For example, an institution must report to the SEC that a material definitive agreement (a contract on which business operations are substantially dependent) was terminated.

Under the reporting requirements in proposed §668.171(d), an institution would notify the Department of any action or event that constitutes an automatic or discretionary trigger no later than 10 days after that action or event occurs. Some of the non-Federal negotiators identified a few events that may not be material or would be resolved during the reporting period and argued that these events should

[36] Generally, a bond rating lower than Baa3 (Moody's) or BBB- (Standard and Poor's, Fitch). www.investopedia.com/exam-guide/series-7/debt-securities/bond-ratings.asp.

not prompt any action by the Department. We agreed, and propose in this NPRM that, to keep the Department apprised, an institution would still be required to report those events but the institution may tell us in its notice why the action or event is not material or that it has been resolved. If we do not agree with the institution's assessment, the Department will notify the institution of the reasons for that determination.

Alternative standards and requirements (§668.175)

Statute: Under sections 437(c) and 464(g) of the HEA, if the Secretary discharges a borrower's liability on a loan due to the closure of an institution, false certification, or unpaid refund, the Secretary pursues a claim against the institution or settles the loan obligation pursuant to the financial responsibility standards described in section 498(c).

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, and to students for refunds of institutional charges, including required refunds of title IV, HEA funds.

Under section 498(h) of the HEA, the Secretary may provisionally certify an institution's eligibility to participate in the title IV, HEA programs for not more than one year in the case of an institution seeking an initial certification, or for no more than three years for an institution that seeks to renew its certification, if, in the judgment of the Secretary, the institution is in an administrative or financial condition that may jeopardize its ability to perform its financial responsibilities under a program participation agreement. If, prior to the end of a period of provisional certification, the Secretary determines that the institution is unable to meet its responsibilities under its program participation agreement, the Secretary may revoke the institution's provisional certification to participate in the title IV, HEA programs.

Current Regulations: Section 668.13(c) of the current regulations identifies the reasons and conditions for which the Secretary may provisionally certify an institution to participate in the title IV, HEA programs, including an institution's failure to meet the standards of financial responsibility under §668.15 or subpart L of the general provisions regulations. Under §668.13(c)(4), an institution may participate in the title IV, HEA programs under a provisional certification if the institution demonstrates to the Secretary's satisfaction that it (1) is capable of meeting the standards of participation in subpart B of the general provisions regulations within a specified period, and (2) is able to meet its responsibilities under its program participation agreement, including compliance with any additional conditions that the Secretary requires the institution to meet for the institution to participate under a provisional certification. If the Secretary determines that the institution is unable to meet its responsibilities under its provisional program participation agreement, the Secretary may revoke the institution's provisional certification as provided under §668.13(d).

As provided under §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) two of the oversight and financial events that an institution currently reports to the Department under the zone alternative in §668.175(d)(2)(ii)--actions by an accrediting agency and any withdrawal of owner's equity from the institution. In addition we propose to remove from §668.175(d)(2) the two reporting events related to loan agreements and debt obligations.

Under the provisional certification alternative in §668.175(f), we propose to add a new paragraph (4) that ties the amount of the financial protection that an institution must provide to the Secretary to an action or triggering event described in §668.171(c). Specifically, under this alternative, an institution would be required to provide to the Secretary financial protection, such as an irrevocable letter of credit, for an amount that is:

- For a State or Federal action under §668.171(c)(1)(i) or (ii), 10 percent or more, as determined by the Secretary, of the amount of Direct Loan Program funds received by the institution during its most recently completed fiscal year;
- For repayments to the Secretary for losses from borrower defense claims under §668.171(c)(2), the greatest annual loss incurred by the Secretary during the three most recently completed award years to resolve those claims or the amount of losses incurred by the Secretary during the current award year, whichever is greater, plus a portion of the amount of any outstanding or pending claims based on the ratio of the total value of claims resolved in favor of borrowers during the three most recently completed award years to the total value of claims resolved during the three most completed award years; and
- For any other action or triggering event described in §668.171(c), or if the institution's composite score is less than 1.0, or the institution no longer qualifies under the zone alternative, 10 percent or more, as determined by the Secretary, of the total amount of title IV, HEA program funds received by the institution during its most recently completed fiscal year.

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

In addition, we propose to add a new paragraph (h) that provides for providing financial protection using a set-aside in lieu of cash or a letter of credit. If an institution does not provide cash or the letter of credit for the amount required to participate under the zone or provisional certification alternatives within 30 days of the Secretary's request, the Secretary would provide funds to the institution only under the reimbursement or heightened cash monitoring payment methods, and would withhold temporarily a portion of any reimbursement claim payable to the institution in an amount that ensures that by the end of a nine-month period, the total amount withheld equals the amount of cash or the letter of credit the institution would otherwise provide. The Secretary would maintain the amount of funds withheld under this offset arrangement in a temporary escrow account, would use the funds to satisfy the debt and liabilities owed to the Secretary that are not otherwise paid directly by the institution, and would return to the institution any funds not used for this purpose during the period for which the cash or letter of credit was required.

Reasons: The reportable items under the zone alternative were intended to alert the Department to adverse actions or events that could occur at any time, or fall outside the scope of activities that are typically included or disclosed in financial statements, and that could further degrade the financial health of an institution with little or no margin against adversity. As noted previously, the Department is taking a more contemporaneous and broader view of the actions or events that are likely to have an adverse impact on an institution, regardless of whether the institution is participating under the zone or another alternative. As such, the reportable events under the zone alternative relating to adverse actions by an accrediting agency or withdrawals of owner's equity fall naturally under the scope of triggering events for the general standards of financial responsibility. With regard to removing the reporting requirements for loan agreements and debt obligations from the zone alternative, we note that while the provisions relating to loan agreements and debt obligations are currently part of the general standards, the Department typically relies on footnote disclosures in the financial statements to determine whether an institution violated those agreements or obligations. Because we would require under proposed §668.171(d) that institutions report these violations no later than 10 days after they occur, there would be no need to maintain the same reporting under the zone alternative.

With regard to the proposed changes under the provisional certification alternative that tie the amount of the financial protection, such as a letter of credit, to an action or triggering event, as explained more fully under the discussion of the general standards in §668.171, every cited action or event is material and, on its own, likely to have an adverse impact on the institution. So, while the Secretary retains the discretion to determine the amount of the financial protection for any action or event, we propose for most of the triggering events to set as a floor the longstanding minimum--10 percent of the amount of title IV, HEA program funds received by the institution during its most recently completed fiscal year. To be clear, each of these triggering events would require a form of financial protection, such as a letter of credit, of at least 10 percent, so an institution with three triggering events would have to submit financial protection for at least 30 percent of its prior year title IV, HEA program funds.

For borrower defense claims, the amount of the financial protection is tied to the prior experience or history of an institution in having to reimburse the Secretary for losses stemming from those claims and the potential for future losses. As proposed, the Department would calculate the amount of the financial protection by looking at the three most recently completed award years and the current award year to determine the year in which the greatest Federal losses occurred, and adding to that amount an estimate for the amount of losses from any outstanding or pending claims. For example, the estimated loss for pending claims would be calculated by multiplying the percentage of prior claims resolved in the students' favor (say 75 percent) by the total amount of the pending claims (say $500,000), or $375,000. In the normal course, the Department would first seek reimbursement from the institution before using the financial protection to recover losses from borrower defense claims.

For a State or Federal action under §668.171(c)(1)(i) or (ii), the amount of the financial protection is based only on Direct Loan funds, instead of all title IV, HEA funds as for all of the other triggers, because the Federal protection sought is related directly to loan liabilities that could arise in the wake of a State or Federal agency suit against the institution.

With regard to the set-aside, the Department wishes to provide an alternative to an institution that, for costs or other reasons, is unable to provide a letter of credit, or cash equivalent to the amount of the letter of credit, within 30 days. However, while we acknowledge that obtaining a letter of credit could be costly and time consuming for some institutions, or obtaining a letter of credit collateralized by physical assets requiring valuation by a bank or creditor could take an extended time, we believe that the severity or potential consequences of the triggering events warrant the Department taking immediate steps to protect the Federal interest. Therefore, if an institution does not provide the letter of credit or cash within 30 days of the Secretary’s request, the Department would initiate administrative offsets to implement the set-aside.

<u>Severability</u>

<u>Current Regulations</u>: None.

<u>Proposed Regulations</u>: Proposed §668.176 would make clear that, if any part of the proposed regulations for part 668, subpart L, whether an individual section or language

within a section, is held invalid by a court, the remainder would still be in effect.

Reasons: We believe that each of the proposed provisions proposed in this NPRM serves one or more important, related, but distinct, purposes. Each of the requirements provides value to students, prospective students, and their families, to the public, taxpayers, and the Government, and to institutions separate from, and in addition to, the value provided by the other requirements. To best serve these purposes, we would include this administrative provision in the regulations to make clear that the regulations are designed to operate independently of each other and to convey the Department's intent that the potential invalidity of one provision should not affect the remainder of the provisions.

Debt Collection

How does the Secretary exercise discretion to compromise a debt or to suspend or terminate collection of a debt? (§30.70)

Statute: Section 432(a) of the HEA authorizes the Secretary to enforce or compromise a claim under the FFEL Program; section 451(b) provides that Direct Loans are made under the same terms and conditions as FFEL Loans; and section 468(2) authorizes the Secretary to enforce or compromise a claim on a Perkins Loan. Section 452(j) of the General Education Provisions Act (GEPA) authorizes certain compromises under Department programs, and 31 U.S.C. 3711 authorizes a Federal agency to compromise or terminate collection of a debt, subject to certain conditions.

Current Regulations: The current regulation in §30.70 was adopted in 1988 to describe the procedures and standards the Secretary follows to compromise, or suspend or terminate collection of, debts arising under programs administered by the Department. The HEA has, since 1965, authorized the Secretary to compromise--without dollar limitation--debts arising from title IV, HEA student loans. The Federal Claims Collection Act of 1966 (FCCA), now at 31 U.S.C. 3711, authorized Federal agencies to compromise, or suspend or terminate collection of, debts, subject to dollar limitations and compliance with the Federal Claims Collection Standards (FCCS), now at 31 CFR 900-904. As in effect in 1988 when the current regulation was adopted, the FCCA required agencies generally to obtain approval from the DOJ in order to resolve debts exceeding $20,000, unless DOJ were to prescribe a higher amount. No higher amount was prescribed, and the Department included that $20,000 dollar limit in §30.70.

In 1988, section 452(j) of GEPA (20 U.S.C. 1234a(j)) was enacted to provide standards and procedures for certain compromises of debts arising under any program administered by the Department other than the Impact Aid Program or HEA programs. These provisions were also included in §30.70(c), (d), and (e). However, in 1989, the Department adopted 34 CFR 81.36 to implement these same GEPA standards; that regulation supersedes current §30.70(c), (d), and (e) to govern compromises of debts under certain Department programs. Compromises of debts under Department programs that do not fall under standards in §81.36 would continue to be subject to the standards and dollar limits generally applicable to Department debts. In 1990, in Pub. L. 101-552, Congress increased the size of debts that agencies may resolve without DOJ approval to $100,000; that change is not reflected in §30.70. Finally, in 2008, Pub. L. 110-315 amended section 432 of the HEA to require the Department to provide DOJ an opportunity to review and comment on any proposed resolution of a claim arising under any of the title IV, HEA loan programs that exceed $1,000,000. That, too, is not reflected in current §30.70.

Proposed Regulations: The proposed changes would revise §30.70 to--

- Reflect the increased debt resolution authority ($100,000);
- Refer to §81.36 to describe the authority and procedures for those compromises of claims that are subject to section 452(j) of GEPA;
- Clarify that the generally applicable $100,000 limit does not apply to resolution of claims arising under the FFEL Program, or under the Direct Loan Program or Perkins Loan Program; and include the requirement that the Department seek DOJ review of any proposed resolution of a claim exceeding $1,000,000 under any of those loan programs.

Reasons: The current regulations do not reflect a series of statutory changes that have expanded the Secretary's authority to compromise, or suspend or terminate the collection of, debts.

Closed School Discharges (§§668.14, 673.33, 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 benefit applies to Direct

Loan borrowers under the parallel terms, conditions, and benefits provisions in section 455(a) of the HEA.

Current Regulations: Section 668.14(b)(31) provides that, as part of an institution's program participation agreement, the institution must submit a teach-out plan, if, among other conditions, the institution intends to close a location that provides 100 percent of at least one program offered by the institution or if the institution otherwise intends to cease operations. 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.

Proposed Regulations: Proposed §668.14(b)(32) would require, as part of its program participation agreement with the Department, a school to provide all enrolled students with a closed school discharge application and a written disclosure, describing the benefits and the consequences of a closed school discharge as an alternative to completing their educational program through a teach-out plan after the Department initiates any action to terminate the participation of the school in any title IV, HEA program or after the occurrence of any of the events specified in §668.14(b)(31) that would require the institution to submit a teach-out plan.

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 for a review of the guaranty agency's decision by the Secretary, and explain how the borrower may request such a review. Proposed §682.402(d)(6)(ii)(K) would describe the responsibilities of the guaranty agency and the Secretary if the borrower requests such a review.

Under current and proposed 682.402(d)(6)(ii)(H) and 685.214(f)(4), as well as under current §§674.33(g)(8)(v), if a FFEL or Direct Loan borrower fails to submit a completed closed school discharge application within 60 days of the notice of availability of relief, the guaranty agency or the Department resumes collection on the loan. However, proposed §§674.33(g)(8)(vi), 682.402(d)(6)(ii)(I), and 685.214(f)(5) would require the guaranty agency or the Department, upon resuming collection, to provide a Perkins, FFEL, or Direct Loan borrower with another closed school discharge application, and an explanation of the requirements and procedures for obtaining the discharge.

Proposed §§674.33(g)(3)(iii), 682.402(d)(8)(iii), and 685.214(c)(2) would authorize the Department, or a guaranty agency with the Department's permission, to grant a closed school discharge to a Perkins, FFEL, or Direct Loan borrower without a borrower application based on information in the Department’s or guaranty agency’s possession that the borrower did not subsequently re-enroll in any title IV-eligible institution within a period of three years after the school closed.

Reasons: Many borrowers eligible for a closed school discharge do not apply. The Department is concerned that borrowers are unaware of their possible eligibility for a closed school discharge because of insufficient outreach and information about available relief. In some instances, the closing school might inform borrowers of the option to complete their program through a teach-out, but fail to advise them of the option for a closed school discharge. Currently, the Department sends identified eligible borrowers an application and an explanation of the qualifications and procedures to obtain a closed school discharge. Schools that close, or close a location, may also conduct teach-outs in accordance with their accreditor’s standards. The proposed amendments to the program participation agreement regulations would provide such information to borrowers earlier in the process, and would help to ensure that the borrowers receive accurate and complete information with regard to their eligibility for a closed school discharge, as well as the consequences of receiving such a discharge.

Non-Federal negotiators cited cases in which schools that were closing or had closed failed to provide complete or accurate information to their students about their options. They described instances in which schools told students that, if the student received a closed school discharge, the credits that the student earned at the school would not be transferable to another school. While borrowers who receive a closed school discharge may be able to transfer the credits that they have earned, others may struggle to find another institution willing to accept those credits. Yet relying on the information provided to them, these borrowers often choose teach-outs rather than closed school discharges. Though teach-outs can be beneficial to borrowers in a closed school situation, a closed school discharge may be a better option for some students.

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

The proposed amendments to the FFEL, Perkins, and Direct Loan regulations, which would require loan holders to send borrowers a second closed school application if a borrower fails to submit an application within 60 days of the date the first application was sent, are intended to provide another opportunity to encourage borrowers who may be eligible for the closed school discharge to apply.

The Department proposed during negotiated rulemaking that the Secretary allow closed school discharges to be granted without an application in all three loan programs if the borrower does not re-enroll in a title IV-eligible program within three years. We asserted that such borrowers can be assumed to not have completed their academic program through a teach-out or transfer, and have included these provisions in the proposed regulations. We also asserted that an application or discharge request in these cases should not be necessary. By amending the regulations to provide for more outreach, disclosure of a borrower's options in a teach-out situation, and review by the Secretary of guaranty agency determinations, we hope to increase the number of eligible borrowers who apply for and receive a closed school discharge.

<u>Death Discharges (§§674.61(a), 682.402(b)(2), 685.212(a), and 686.42(a))</u>

<u>Statute</u>: Section 420N(d)(2) of the HEA provides for the Secretary to establish, through regulation, categories of extenuating circumstances under which a TEACH Grant recipient who is unable to satisfy all or part of the TEACH Grant service obligation may be excused from fulfilling that portion of the service obligation.

Section 437(a)(1) of the HEA provides for the discharge of a loan made under the FFEL Program if the borrower dies. In accordance with section 455(a)(1) of the HEA, this discharge provision also applies to loans made under the Direct Loan Program.

Section 464(c)(1)(F)(i) provides that the liability to repay a Perkins Loan is cancelled upon the death of the borrower.

Current Regulations: For the Perkins Loan Program, §674.61(a) provides that an institution must discharge the unpaid balance on a Perkins Loan if the borrower dies. For the FFEL Program and the Direct Loan Program, §§682.402(b)(2) and 685.212(a)(1), respectively, provide for the discharge of a loan based on the death of the borrower or, in the case of a PLUS loan made to a parent, the death of the student on whose behalf the parent borrowed. For the TEACH Grant Program, §686.42(a) specifies that the Secretary discharges a grant recipient's obligation to complete the agreement to serve if the grant recipient dies. For all of these programs, the current regulations specify that a death discharge can be granted based on an original or certified copy of the borrower's, student's, or TEACH grant recipient's death certificate; an accurate and complete photocopy of the original or a certified copy of the death certificate; or, on a case-by-case basis, other reliable documentation of the individual's death.

Proposed Regulations: We propose to amend §§674.61(a), 682.402(b)(2), 685.212(a), and 686.42(a) to allow for death discharges to be granted based on an accurate and complete original or certified copy of a death certificate that is scanned and submitted electronically or sent by facsimile transmission, or verification of a borrower's, student's or TEACH Grant recipient's death through an authoritative Federal or State electronic database that is approved for use by the Secretary. The proposed regulations would also make minor changes to the current death discharge regulatory language to make it more consistent across the title IV, HEA programs.

Reasons: The proposed regulations would streamline the death discharge process and reduce administrative burden by allowing for death certificates to be submitted electronically or by facsimile transmission, and would further simplify the process in the future by allowing for death discharges to be granted based on verification of an individual's death through an authoritative Federal or State electronic database that the Secretary authorizes to be used for this purpose.

During the negotiations, a non-Federal negotiator asked if, under the proposed regulations, it would be permissible for a loan holder to automatically grant a death discharge based on verification of a borrower’s or student’s death in an approved State or Federal electronic database, without the loan holder having received a request for the death discharge from a family member. The Department responded that loan holders can only grant death discharges after being informed of the borrower's or student's death by a family member or other representative of the deceased individual, but that they can use the information in an approved electronic database as the necessary supporting documentation for doing so.

Interest Capitalization (§§682.202(b)(1), 682.410(b)(4), and 682.405)

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

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.

Proposed Regulations: The proposed revisions to the above-referenced regulations would clarify that the only time that a guaranty agency may capitalize interest is when it pays the FFEL Program lender's default claim and, therefore, that capitalization by the guaranty agency when selling a rehabilitated FFEL Loan is not permitted. Similarly, the proposed regulations would clarify that capitalization by the FFEL Program lender when purchasing a rehabilitated FFEL Loan is not permitted. The proposed regulations would also clarify, through a conforming change, 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, capitalization is not permitted if collection on the loan resumes because the borrower does not return the appropriate form within the allotted timeframe.

Reasons: Currently, some guaranty agencies and FFEL Program lenders capitalize interest when the borrower rehabilitates the loan, while others do not. Also, some guaranty agencies capitalize interest when resuming collection on a defaulted FFEL Loan when a borrower has not submitted a closed school or false certification discharge with a specific timeframe. The Department does not believe that interest capitalization in either circumstance is warranted, and the Department does not capitalize interest on loans that it holds in comparable circumstances. Further, the Department believes that FFEL Program lenders, in the case of a rehabilitated FFEL Loan, have sufficient tools at their disposal to ensure that a rehabilitated loan that has an outstanding interest balance is repaid in full by the end of the applicable repayment period or, in the case of the income-based repayment plan, forgiven.

Loan Repayment Rate Warnings and Financial Protection Disclosures (§668.41)

Statute: Under 20 U.S.C. 1221-3 and 3474, the Secretary is authorized to adopt such regulations as needed for the proper administration of programs.

Current Regulations: Current §668.41 requires institutions to make certain general disclosures of information to enrolled and prospective students, including availability of financial assistance, detailed institutional information, retention rate, completion and graduation rates, and placement of and types of employment obtained by graduates. Section 668.41 further requires specialized disclosures related to the "Annual Security Report and Annual Fire Safety Report," the "Report on Completion or Graduation Rates for Student-Athletes," and the "Report on

Athletic Program Participation Rates and Financial Support Data."

<u>Proposed Regulations</u>:

<u>Proprietary Institution Loan Repayment Warning</u>

Proposed §668.41(h) would expand the reporting and disclosure requirements under §668.41 to provide that, for any fiscal year in which an affected postsecondary institution has a loan repayment rate that is less than or equal to zero, the institution must deliver a Department-issued plain language warning to prospective and enrolled students and place the warning on its Web site and in all promotional materials and advertisements. In accordance with proposed §668.41(h)(6), the Department would not calculate a repayment rate for an institution whose cohort is based on fewer than 10 borrowers. An institution with 10 or more borrowers that receives a failing repayment rate will have the opportunity to appeal its rate if the institution demonstrates that it has a low participation rate under the Direct Loan program by applying, with slight modifications, the participation rate index calculation described in §668.214(b)(1) that institutions may use to appeal a loss of eligibility due to high cohort default rates or placement on provisional certification.

Consistent with the existing process, in calculating the participation rate index for the purposes of proposed §668.41(h)(6), the institution would divide the number of students receiving a Direct Loan to attend the institution during a period of enrollment that overlaps any part of a 12-month period that ended during the six months immediately preceding the fiscal year for which the Department calculated the loan repayment rate, by the number of regular students enrolled at the institution on at least a half-time basis during any part of the same 12-month period. The resulting percentage would then be multiplied by 30 percent to yield a participation rate. A figure of 30 percent is used because that is the minimum cohort default rate that could precipitate a participation rate challenge. A participation rate equal to or less than 0.0625 for a fiscal year in which the Department has calculated a loan repayment rate would exempt the institution from having to deliver a loan repayment warning under proposed §668.41(h).

Under proposed §668.41(h)(3), for each fiscal year, the Secretary would calculate the loan repayment rate for a proprietary institution based on the cohort of borrowers whose Direct Loans entered repayment at any time during the fifth fiscal year prior to the most recently completed fiscal year. The percentage change between what we refer to as the “original outstanding balance (OOB)” (the amount owed, as defined more specifically in proposed §668.41(h)(2)(ii), when the borrower enters repayment, including any accrued interest) and the “current outstanding balance” (including principal and both capitalized and uncapitalized interest) as of the end of the prior fiscal year for each borrower in the cohort would be calculated and expressed as a percentage reduction of, or increase in, the OOB. For any loan reported as being in default status at any time during the “measurement period” and where there is a percentage reduction of the original balance, the difference between the OOB and COB would be considered to be zero; and for any loan that defaulted and had a percentage increase from the original balance, the difference between the OOB and COB would be that percentage increase. “Measurement period” is defined in proposed §668.41(h)(2)(iv) as the period of time between the date a borrower’s loan enters repayment and the end of the fiscal year for which the current outstanding balance of that loan is determined. The OOB of a loan does not include PLUS loans made to parent borrowers, Perkins loans, or TEACH Grant-related loans. For consolidation loans, the OOB includes only those loans attributable to the borrower’s enrollment in the institution. A median value is then determined on a scale where percentage reductions in original outstanding balance are positive values and percentage increases in original balance are negative values. The median value for all included borrowers at an institution is the institution's loan repayment rate for that year.

Proposed §668.41(h)(4) would provide certain exclusions from the above calculation. The Secretary would exclude a borrower from the calculation if one or more of the borrower's loans were in a military deferment status during the last fiscal year of the measurement period; one or more of the borrower's loans are either under consideration by the Secretary, or have been approved, for discharge on the basis of the borrower's total and permanent disability under §682.402 or §685.213; the borrower was enrolled in an institution during the last fiscal year of the measurement period; or the borrower died.

In proposed §668.41(h)(5), we describe the process by which the Department would notify an institution of its loan repayment rate, and provide the institution an opportunity to challenge that rate. Specifically, the Department would provide to each institution a list of students in the cohort as determined under proposed

§668.41(h)(3), the draft repayment rate for that cohort, and the information used to calculate the draft rate. The institution would have 45 days to challenge the accuracy of the information used to calculate the draft rate. After considering any challenges to the draft rate made by the institution, the Department would notify the institution of its final repayment rate and whether the institution must deliver a loan repayment warning to students.

Financial Protection Disclosure

Under proposed §668.41(i), institutions that are required to provide financial protection, including an irrevocable letter of credit or cash under proposed §668.175(d) or (f), or set-aside under proposed §668.175(h), would have to disclose that status, which would include information about why the institution is required to provide financial protection, to both enrolled and prospective students until released from the obligation to provide financial protection by the Department.

Disclosures to Students

Under proposed §668.41(h)(7), an institution that is subject to the loan repayment warning must provide that warning to prospective and enrolled students and place the warning on its Web site and in all advertising and promotional materials in a form and manner prescribed by the Department in a notice published in the Federal Register. Prior to publishing the notice, the Department would conduct consumer testing to improve the effectiveness of the warning language.

Under proposed §668.41(h)(7), an affected institution would be required to provide the loan repayment warning to both enrolled and prospective students by hand delivering the warning as part of a separate document to the student individually or as part of a group presentation. Alternatively, an institution could send the warning to a student's primary email address or by another electronic communication method used by the institution for communicating with the student. In all cases, proposed §668.41(h)(7) would require the institution to ensure that the warning is the only substantive content in the message, unless the Secretary specifies additional, contextual language to be included in the message. Institutions would be required to provide a prospective student with the warning before the student enrolls, registers, or enters into a financial obligation with the institution.

Proposed §668.41(h)(8) would also require that all promotional and advertising materials prominently include the warning. Promotional materials include, but are not limited to, an institution's Web site, catalogs, invitations, flyers, billboards, and advertising on or through radio, television, print media, social media, or the Internet. Proposed §668.41(h)(8) would further require that all promotional materials, including printed materials, about an institution be accurate and current at the time they are published, approved by a State agency, or broadcast.

Finally, an institution would, under proposed §668.41(h)(9), be required to post the warning on the home page of the institution's Web site, in a simple and meaningful manner, within 30 days of the date the institution is informed by the Department of its final loan repayment rate. The warning must remain posted to the institution's Web site until the Department notifies the institution that it is no longer under a requirement to do so as a result of having a loan repayment rate greater than zero percent.

Under proposed §668.41(i), an affected institution would be required to provide the financial protection disclosure to enrolled and prospective students in the manner described in proposed §668.41(h)(7). An affected institution would also be required to post the disclosure on the home page of the institution's Web site in the manner described in proposed §668.41(h)(9) no later than 30 days after the date on which the Secretary informs the institution of the need to provide financial protection, until such time as the Secretary releases the institution from the requirement that it provide financial protection.

Reasons: In deciding to enroll or continue attendance at any institution of higher education, students are making a substantial personal commitment that may mean incurring considerable amounts of student loan debt. Such a decision should, to the greatest extent possible, be an informed one. We believe that the warning related to loan repayment under proposed §668.41(h) and the financial protection disclosure under §668.41(i) would provide students with important information in making their educational and financial decisions.

Loan Repayment Rate

The loan repayment rate warning would provide enrolled and prospective students with valuable information about the repayment outcomes associated with the Federal student loan debt incurred by students who attend a proprietary institution. Zero percent or negative loan repayment rates indicate that borrowers at the institution are likely to have experienced financial distress as they attempted to repay their loans and may continue to experience difficulty. Loans in negative amortization status are viewed with concern.[37] Students who borrow to attend institutions should reasonably expect to be in a financial position that enables them to pay down their loans after leaving. Warning students of institutions with particularly low--zero percent or negative--repayment rates will give them critical information on which to base enrollment and borrowing decisions.

Based on internal analysis of data from the National Student Loan Data System (NSLDS), the typical borrower in negative amortization--more than half of those who have made no or negative repayment progress five years after leaving school--experienced long-term repayment hardship such as default. Those borrowers are especially unlikely to satisfy their loan debt in the long-term.[38, 39] In particular, we believe that it strikes an appropriate balance to measure repayment rates after five years, given that those data show that a substantial proportion of

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[37] Looney, Adam and Constantine Yannelis. "A Crisis in Student Loans? How Changes in the Characteristics of Borrowers and in the Institutions They Attended Contributed to Rising Loan Defaults." Brookings Institution: http://www.brookings.edu/~/media/projects/bpea/fall-2015/pdflooneytextfallbpea.pdf.

[38] Borrowers in negative amortization would be considered to have a "negative repayment rate" under the proposed regulations.

[39] Analysis of NSLDS data was based on a statistical sample of three cohorts of borrowers with FFEL Loans and Direct Loans entering repayment in 1999, 2004, and 2009, respectively. The repayment statuses of the loans were tracked in five -year intervals at five, ten, and fifteen years after entry into repayment, depending on the age of the cohort.

borrowers whose loans are in negative amortization five years after entering repayment remain in negative amortization or have defaulted on their loans 10 and even 15 years after entering repayment.

Several non-Federal negotiators expressed concerns about the additional administrative burden that would be associated with the proposed regulations. Several non-Federal negotiators argued that both the opportunity to review and correct data calculated by the Department, as well as the obligation to ensure the warnings are properly provided to all prospective and enrolled students, would add significant burden for those institutions. Some of those negotiators suggested that institutions should be able to satisfy the warning requirement by providing a link from the institution’s Web site to the College Scorecard. Others recommended that the Department be responsible for the dissemination of loan repayment rates and associated warnings, perhaps through the Free Application for Federal Student Aid (FAFSA). Still others proposed the Department explore ways to limit the warning requirement only to those institutions that contribute most to negative repayment outcomes.

In response to suggestions that the Department assume responsibility for disseminating loan repayment rates, we believe that schools, as the primary and on-the-ground communicators with their students and the source of much of the information students receive about financial aid, are well placed to reach their students and to notify them of the potential risks of borrowing at that institution.

Nonetheless, we recognize the potentially increased administrative responsibilities attendant to the proposed requirement and agree with the negotiators who suggested minimizing administrative burden by applying this requirement only to the sector of institutions where the frequency of poor repayment outcomes is greatest. Analysis of repayment performance under the proposed methodology shows that zero and negative repayment outcomes are endemic to the proprietary sector, but are relatively rare in the public and non-profit sectors.[40] Proprietary institutions are far more likely to have poor repayment rates, along with lower post-college earnings and higher default rates, than public or non-profit institutions, and therefore pose the greatest risk to students and taxpayers.[41, 42] For

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[40] Analysis of NSLDS data was based on a cohort of borrowers with FFEL Loans and Direct Loans who entered repayment in 2009. The repayment status of loans taken out for attendance at each institution was observed five years after entry into repayment.

[41] The For-Profit Postsecondary School Sector: Nimble Critters Or Agile Predators? www.nber.org/papers/w17710.pdf; and Miller, Ben and Antoinette Flores. September 2015. Initial Analysis of College Scorecard Earnings and Repayment Data. www.americanprogress.org/issues/higher-

instance, a preliminary Department analysis of the College Scorecard five-year undergraduate repayment rates (using a comparable threshold of 50 percent of borrowers or fewer making progress on their loans) shows that more than 70 percent of institutions with a repayment rate below the threshold are proprietary institutions, and those institutions represent more than two in five of all proprietary institutions. On the other hand, at both public and private nonprofit institutions, fewer than 10 percent of institutions had repayment rates below the threshold.[43] Based on this analysis, the financial risk to students is far more severe in the proprietary sector; so we propose to limit the burden of the warning requirement only to those institutions. Accordingly, the proposed warning requirement is tailored to address the sector in which these issues are most concentrated. By doing so, we would limit burden on postsecondary institutions generally

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education/news/2015/09/17/121485/initial-analysis-of-college-scorecard-earnings-and-repayment-data/.

[42] Looney, Adam and Constantine Yannelis. "A Crisis in Student Loans? How Changes in the Characteristics of Borrowers and in the Institutions They Attended Contributed to Rising Loan Defaults." Brookings Institution: http://www.brookings.edu/~/media/projects/bpea/fall-2015/pdflooneytextfallbpea.pdf.

[43] Analysis of the Department's College Scorecard data was based on a combined cohort of borrowers with FFEL Loans and Direct Loans who entered repayment in 2008 and 2009. At schools where fewer than 50 percent of borrowers have repaid at least $1 on their loans (as is calculated using the Scorecard methodology), the median borrower has repaid nothing on his loans.

and better target the Department’s efforts to provide valuable consumer information.

Several non-Federal negotiators also expressed concerns about the methodology for calculating the repayment rate. One negotiator, commenting on how the cohorts for this proposed repayment rate are determined, objected to the use of a five-year horizon on the grounds that students progressing directly to graduate study following completion of an undergraduate degree may be shortly out of school and in forbearance or otherwise have accrued interest at the time of the calculation. Another negotiator expressed concerns that the proposed new methodology would be overly punitive toward institutions with historically underserved student populations, and that disclosure of resulting loan repayment rates would, to an unfair degree, reflect negatively on them.

While we appreciate the concerns and suggestions raised by negotiators, we maintain that the loan repayment rate methodology in proposed §668.41(h)(3) results in a rate that would provide useful new information. Specifically, this rate would effectively identify the proprietary institutions that are generating zero or negative repayment outcomes and that should be providing warnings to students as they are assessing the likelihood of their ability to repay the loan debt they may incur for enrollment at a particular institution, based on the outcomes of former students who have already entered repayment. Other repayment rate methodologies, such as those used for the disclosures required under the Gainful Employment rule and College Scorecard, calculate the share of borrowers who have reduced their principal balance by at least one dollar. The rate proposed in this regulation would measure the extent to which students repaid their loans, identifying those proprietary institutions at which students are least likely to repay their loans in full. Moreover, the Department will look for ways to harmonize the multiple repayment rate methodologies, contingent on consumer testing and user needs.

We recognize that not all institutions present similar risk. Therefore, institutions with low numbers of borrowers and low borrowing rates are accordingly exempted from the proposed warning requirement. As discussed above, proposed §668.41(h)(6) would exempt an institution from the warning requirement if its repayment rate is based on fewer than 10 borrowers who have entered repayment in the fiscal year; or if the institution demonstrates that it has a low participation rate under the Direct Loan program. The exemption for a repayment rate calculation based on fewer than 10 borrowers reflects the concern that individuals comprising so small a cohort might be able to be identified, potentially compromising the privacy of those individuals. We propose the low participation rate exemption in recognition that, if the number of students who borrow Direct Loans constitutes a small percentage of the institution's students, in some cases due to the institution's low tuition costs, the loan repayment outcomes of those students may not provide a full picture of student experiences at the institution.

Under the proposed calculation, borrowers who default at any point during the measurement period on their loans and who see a percentage reduction in their loan balances are treated as "zero" for the purposes of the repayment rate; borrowers who default and see a percentage increase in their loan balances are counted by the actual percentage increase. Given the significant impact that defaulting has on borrowers' financial circumstances, this provision is designed to ensure that institutions are held accountable for, and appropriate weight is placed on, those students' loan repayment outcomes.

In addressing the negotiators' concerns related to basing the cohort on a five-year horizon beyond the fiscal year when borrowers entered repayment, and the possibility that some students may still be enrolled in or have recently separated from school, we note that borrowers who are enrolled in an institution (either the same or another institution) at any time during the last fiscal year of the measurement period are excluded from the calculation. Even those students recently out of school and remaining in a forbearance status (having made no payments on their loans) would not be included unless their loans went into repayment at some time during the fifth prior fiscal year. We also believe that the other exceptions included in proposed §668.41(h)(4) strengthen the accuracy of the rate.

Regarding concerns that proposed §668.41(h) would unfairly target institutions whose enrollment is largely composed of underserved or economically disadvantaged populations, the Department holds that the requirement would not identify institutions on the basis that they enroll large numbers of underserved or economically disadvantaged populations. Rather, it would identify institutions at which borrowers on average are unable to repay their loans and accordingly pose a disproportionate risk to both students and taxpayers. Borrowers are responsible for managing debt payments, which begin shortly after they complete a program, even in the early stages of their career, and even if they come from economically disadvantaged backgrounds. As the U.S. District Court for the District of Columbia stated in Association of Private Sector Colleges & Universities v. Duncan, 110 F.Supp.3d 176, 194 (D.D.C. June 23, 2015), "[W]hen graduates get low-paying jobs and then default on their student loans, nobody wins--not the government (which picks up the tab), and not the student (who may get back on her feet eventually, but who--in the meantime--may be denied credit, miss bill due dates, or even file for bankruptcy)." Indeed, the Department believes it is even more important to warn students from disadvantaged populations about the poor repayment outcomes of an institution at which they are considering enrolling because they will bear the same responsibility for managing their debt as everybody else.

One negotiator expressed concerns over the intended scope of the term "promotional materials" as now defined in proposed §668.41(h)(8), pointing out that, at some large institutions, it would be difficult to put reasonable parameters around what might be considered promotional material. Other negotiators felt that the speed with which information about their institutions can be spread using social media, and the potential scale of dissemination, would make it impossible for them to ensure compliance with the proposed regulations.

Proposed §668.41(h)(8)(ii) identifies the most commonly used methods to promote and advertise an institution, with the qualification that this list is not exhaustive and promotional materials are not limited to items on the list. We expect institutions to include the required warning in such other comparable media and formats in which they promote and advertise themselves. We invite comment on ways the Department can ensure that this warning, when included in promotional and advertising materials, is not hidden or presented in a way that makes it difficult for the public to see. Regarding the inclusion of social media as promotional material, we acknowledge the concerns related to potential burden and scope expressed by negotiators. To that end, we clarify here that it is not our intention for every "post" on a social media site or every individual "Tweet" to be considered promotional material. However, an institution's landing page on a social media platform is considered to be promotional material, as are any advertisements. On any social media profile/page that an institution maintains on such a platform, the institution would be required to include the warning.

Financial Protection

The proposed financial protection disclosure would provide enrolled and prospective students with valuable information about the viability of the institution as a participant in the Federal financial aid programs. Under proposed §668.175(d), (f), or (h), some institutions would be required to provide financial protection, such as an irrevocable letter of credit, if the institution is not financially responsible because of an action or event described in proposed §668.171(b) or (c). We believe that current and prospective students have a demonstrable interest in being made aware of the specific reasons for which their institution was required to provide any financial protection because these are factors that could have a significant impact on a student's ability to complete his or her education at an institution. For the thousands of students in recent years whose institutions have closed their doors precipitously, advance notice that those institutions faced significant financial risk and compliance issues could have allowed students time to reevaluate their decision to remain at an institution and choose to instead continue their education without interruption at an institution where the prospects for completing their education are more certain. We also believe that students are entitled to know about any such event that is significant enough to warrant disclosure to investors since students can have an equal, if not greater, financial stake in the continued operation of their institution.

Method of Delivery

These provisions are designed to ensure that students receive any required loan repayment rate warning or financial protection disclosure. The information we propose to require in the loan repayment rate warning and financial protection disclosure pertains to material and deeply concerning problems at an institution that create significant risk to the educational prospects of students enrolling or already enrolled at that institution. Students deserve to know information that could have a significant impact on or relate to their chances of success.

In addition to our interest in ensuring that students have accurate and complete information on which to base decisions about attending an institution, the Department has a significant interest in ensuring transparency more broadly. Recent events involving the closure of several large proprietary institutions have shown the need for lawmakers, regulatory bodies, State authorizers, taxpayers, and students to be more broadly aware of circumstances that could affect the continued existence of an institution.

Though these additional disclosure requirements are not a singular remedy for this problem, we believe them to be an important step toward creating a more transparent environment in which institutions participate in the title IV, HEA programs.

Some negotiators objected to the lack of specificity with respect to the wording of the proposed warning. Our intent, however, is to build a certain amount of flexibility into the proposed regulations to ensure that the warning is as meaningful as possible to its intended audience. Accordingly, under proposed §668.41(h)(7)(i), the Department would conduct consumer testing to help improve the effectiveness of the warning language. Upon completion of consumer testing, the final language would be published in the Federal Register. For illustrative purposes, we include examples of possible repayment rate warning language below:

- U.S. Department of Education Warning: A majority of borrowers at this school are not likely to repay their loans.
- U.S. Department of Education Warning: A majority of borrowers at this school have difficulty repaying their loans.

* U.S. Department of Education Warning: Most of the students who attended this school owe more on their student loans five years after leaving school than they originally borrowed.

During negotiated rulemaking, the Department proposed requiring institutions to deliver any loan repayment rate warning or financial protection disclosure to prospective students at the first contact with those students. Negotiators requested clarification of what is considered "first contact," believing it to be particularly difficult to establish at large institutions with which potential students regularly interact prior to enrolling. We agree with the negotiators that, in many cases, a point of first contact between an institution and a student may not be easy to isolate. Accordingly, we propose in §668.41(h)(7)(iii) to state that an institution must provide the warning or disclosure required under this section to a prospective student before that student enrolls, registers, or enters into a financial obligation with the institution.

Initial and Final Decisions (§668.90)

Statute: Section 498(d) of the HEA provides that the Secretary is authorized 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, 20 U.S.C. 1094(c)(1)(F), 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 §668.90. In addition to describing the procedures for issuing initial and final decisions, §668.90 also provides requirements for hearing officials in making initial and final decisions in specific circumstances.

These regulations generally provide that the hearing official determines 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 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, §668.90(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.

<u>Proposed Regulations</u>: The Secretary proposes to amend §668.90(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. Additionally, §668.90(a)(3)(iii) would be modified to require the hearing official to uphold 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 is based no longer exist or have been resolved in a manner that eliminates the risk they posed to the institution's ability to meet its financial obligations, or has now provided the required financial protection. We propose to further modify §668.90(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 §668.90(a)(3)(v) would state that these circumstances would be compliant 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) or §668.175(g).

Reasons: The proposed changes to §668.90(a)(3)(iii) would update the regulations to reflect both the current language in §668.175 and proposed changes to that section. The changes would also create specific conditions under which the hearing official may find that the letter of credit or financial protection amount demanded would not be warranted. We believe that the new language would provide more clarity than the current standard, which only notes that the institution has to show that the amount was "unreasonable." The proposed language would clearly establish that the amount would be unwarranted only if the reasons for which the Secretary required the financial protection no longer exist or have been resolved, or if some other acceptable form of financial protection arrangement is in place with the Secretary.

Our proposed revisions to §668.90(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 in order to be financially responsible. We propose to modify §668.90(a)(3)(iii) to reflect that language as well as changes proposed now to §668.175 by substituting the terms "letter of credit or other financial protection" for "surety." Thus, the proposed changes to §668.90 would clarify that a limitation, suspension, or termination action may involve a failure to provide any of the specified forms of financial protection, letter of credit or otherwise.

We further propose to modify §668.90(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. The proposed change would provide that a hearing official must adopt the amount of the letter of credit or financial protection demanded by the Secretary, unless the institution demonstrates that the events or conditions forming the grounds for the financial protection or letter of credit no longer exist or have been resolved in a manner resolving the risk posed to the institution's ability to meet its financial obligations. The institution would be permitted to demonstrate that the Department miscalculated the amount on which the demand is grounded. However, it could not claim that the event does not constitute grounds for a 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 institution could challenge a demand for protection based on delinquency on secured debt by proving that the delinquency has been cured or a workout satisfactory to the secured lender has been arranged. In the case of a demand for financial protection based on pending litigation, the institution would be permitted to demonstrate that the suit was dismissed or settled favorably. Alternatively, the institution could demonstrate that it has provided the Department with appropriate alternative financial protection (cash or a reimbursement funding arrangement with the Secretary that will result in set-aside of the amount required within an agreed timeframe).

The proposed changes to §668.90(a)(3)(v) would also clarify and conform with other existing regulations the alternative methods in current regulations by which an institution may be able to meet the financial responsibility standards, and thus would be able to claim that a limitation or termination is unwarranted. Section 668.90(a)(3)(v) would be revised to state the grounds on which a hearing official is authorized to find that a termination or limitation action brought for a failure of financial responsibility for 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. None of these provisions would be changed under these proposed regulations. The changes would not add substantive new restrictions, but simply conform §668.90 to these substantive requirements already in current regulations. Thus, as revised, §668.90(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 alternative in current §668.175(f). For an action based on 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 the institution has accepted provisional certification and provided the financial protection required under §668.175(g).

<u>Limitation (§668.93)</u>

<u>Statute</u>: 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 a challenge to such a limitation. Current §668.93 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 668.93(i).

Although a change in an institution's status from fully certified to provisionally certified is not currently a limitation listed in §668.93, §668.13(c) provides 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 the provisions of §668.171 or §668.175.

Proposed Regulations: The Secretary proposes to amend §668.93 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 §668.93 would clarify current policy and provide for a more complete set of limitations covered in §668.93.

Pay As You Earn (PAYE) and Revised Pay As You Earn (REPAYE) Repayment Plans (§685.209(a) and (c))

Statute: Section 455(d)(1)(D) of the HEA authorizes the Secretary to offer Direct Loan borrowers (except parent PLUS borrowers) an income-contingent repayment (ICR) plan with varying annual repayment amounts based on the income of the borrower, for a period of time prescribed by the Secretary, not to exceed 25 years. Section 455(e)(1) of the HEA authorizes the Secretary to establish ICR plan repayment schedules through regulations.

Current Regulations: For the PAYE Plan and the REPAYE Plan, current §685.209(a)(1)(ii) and (c)(1)(ii), respectively, define "eligible loan" as "any outstanding loan made to a borrower under the Direct Loan Program or the FFEL Program except for a defaulted loan, a Direct PLUS

Loan or Federal PLUS Loan made to a parent borrower, or a Direct Consolidation Loan or Federal Consolidation Loan that repaid a Direct PLUS Loan or Federal PLUS Loan made to a parent borrower.”

For the REPAYE Plan, current §685.209(c)(2)(ii)(B) provides that if a married borrower and the borrower's spouse each have eligible loans, the Secretary adjusts the borrower’s REPAYE Plan monthly payment amount by determining each individual’s percentage of the couple's total eligible loan debt and then multiplying the borrower's calculated REPAYE Plan monthly payment amount by this percentage.

For the REPAYE Plan, current §685.209(c)(4)(iii)(B) specifies that the annual notification to a borrower of the requirement to provide updated income and family size information explains the consequences, including the consequences described in §685.209(c)(4)(vi), if the Secretary does not receive the information within 10 days following the annual deadline specified in the notification. Paragraph (c)(4)(vi) of §685.209 provides that if the Secretary removes a borrower from the REPAYE Plan because the borrower has failed to provide updated income information by the specified deadline, the Secretary sends the borrower a written notification containing the borrower's new monthly payment amount and providing other information, including the borrower's option to change to a different repayment plan and the conditions under which the borrower may return to the REPAYE Plan.

Proposed Regulations: The proposed regulations make technical changes to amend §685.209(a)(1)(ii) of the PAYE Plan regulations by adding language to the definition of "eligible loan" stating that this term is used for purposes of determining whether a borrower has a partial financial hardship and adjusting the monthly payment amount for certain married borrowers. The definition of "eligible loan" in §685.209(c)(1)(ii) of the REPAYE Plan regulations would be amended by adding language stating that this definition is used for purposes of adjusting the monthly payment amount for certain married borrowers.

The proposed regulations would amend §685.209(c)(2)(ii)(B) of the REPAYE Plan regulations by adding language to provide that there is no adjustment to a married borrower's monthly payment amount based on the eligible loan debt of the borrower's spouse if the spouse's income is excluded from the calculation of the borrower's monthly payment amount in accordance with §685.209(c)(1)(i)(A) or (B).

The proposed regulations would revise §685.209(c)(2)(v) of the REPAYE Plan regulations by removing language that refers to the Secretary's determination that the borrower does not have a partial financial hardship. Finally, the proposed regulations also would revise §685.209(c)(4)(iii)(B) of the REPAYE Plan regulations by removing the cross-reference to §685.209(c)(4)(vi).

Reasons: The language that would be added to the definitions of "eligible loan" in the PAYE and REPAYE plan regulations is intended to clarify that the inclusion of certain types of FFEL Loans in the definitions of "eligible loan" does not mean that these loans may be repaid under the PAYE or REPAYE plans. The PAYE and REPAYE plans are available only for Direct Loans. The proposed language would clarify that the FFEL Loans listed in the definitions are taken into consideration only for certain purposes related to the terms and conditions of the PAYE and REPAYE plans.

The proposed change in §685.209(c)(2)(ii)(B) is needed to accurately reflect that the monthly payment amount for a married borrower who files a separate Federal income tax return from his or her spouse is not adjusted to take into account the spouse's eligible loan debt if the spouse's income is excluded from the calculation of the borrower's monthly payment amount in accordance with §685.209(c)(1)(i)(A) or (B). Paragraphs (c)(1)(i)(A) and (B) provide that only the borrower's income is used to calculate the monthly REPAYE Plan payment amount if a married borrower filing separately is separated from his or her spouse or is unable to reasonably access the spouse's income information.

The proposed change in §685.209(c)(4)(iii)(B) removes an unnecessary reference to the requirement for the annual notification informing a borrower of the need to recertify income and family size to provide information about the contents of a separate notification required under §685.209(c)(4)(vi) that will be sent if the borrower is removed from the REPAYE Plan as a result of failure to recertify income. The information included in that separate notification is not applicable at the time a borrower is merely being notified of the requirement to annually recertify income and family size.

The removal of the reference to partial financial hardship in §685.209(c)(2)(v) reflects that the concept of partial financial hardship does not apply under the terms and conditions of the REPAYE Plan.

<u>False Certification Discharges (§685.215)</u>

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 provisions 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 did not meet the eligibility requirements in section 484(d) of the HEA. Section 685.215(a)(1)(iii) provides that a borrower may qualify for a false certification discharge if the school certified the eligibility of a student who would not meet requirements for employment in the occupation for which the training program supported by the loan was intended due to a physical or mental condition, age, criminal record, or other requirement accepted by the

Secretary that was imposed by State law. Section 685.215(c) and (d) describes the qualifications and procedures for receiving a false certification discharge.

Proposed Regulations: Proposed §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 under section 484(d) of the HEA.

Under proposed §685.215(a)(1)(ii), if a school certified the eligibility of a borrower who is not a high school graduate (and does not meet applicable alternative to high school graduate requirements) the borrower would qualify for a false certification discharge if the school falsified the borrower's high school graduation status; falsified the borrower's high school diploma; or referred the borrower to a third party to obtain a falsified high school diploma.

Proposed §685.215(a)(1)(iv) would specify that a borrower qualifies for a false certification discharge if the borrower failed to meet applicable State requirements for employment due to a physical or mental condition, age, criminal record, or other reason accepted by the Secretary that would prevent the borrower from obtaining employment in the occupation for which the training program supported by the loan was intended.

Proposed §685.215(c) would update the information specifying how a borrower applies for a false certification discharge. It would also specify that the Department would notify a borrower who applies but does not meet the requirements for a false certification discharge and explain why the borrower does not meet the requirements.

Proposed §685.215(c)(1) would describe the requirements a borrower must meet to qualify for a discharge due to a false certification of high school graduation status.

Proposed §685.215(c)(2) would state the requirements a borrower must meet to obtain a discharge based on a disqualifying condition, as specified in proposed §685.215(a)(1)(iv).

Proposed §685.215(c)(8) would amend the provisions for granting a false certification discharge without an application to include cases in which the Department has information in its possession showing that the school has falsified the Satisfactory Academic Progress (SAP) of its students.

Proposed §685.215(d) would update the procedures for applying for a false certification discharge, and describe the types of evidence that the Department uses to determine eligibility for a false certification discharge. It would also provide that the Department will explain to the borrower the reasons for a denial of a false certification discharge claim, describe the evidence that the determination was based on, and provide the borrower with an opportunity to submit additional evidence supporting his or her claim. The Department would consider the response from the borrower, and notify the borrower whether the determination of eligibility has changed.

Reasons: We propose to remove 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." Currently 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 incorporate the statutory language in the regulations, so that any future changes to that language would be incorporated into the regulation. The changes we propose to make to §685.215(c)(1) (currently titled

“Ability to benefit”) are intended to conform to these changes.

The proposed revisions to §685.215(a)(1)(i) and (ii) are intended to state more explicitly that a school’s certification of eligibility for a borrower who is not a high school graduate, and does not meet the alternative to high school graduate requirements, is grounds for a false certification discharge. We propose these changes specifically to address the problem of schools encouraging non-high school graduates to obtain false high school diplomas to qualify for Direct Loans. Many non-Federal negotiators noted that often borrowers are misled by schools. These non-Federal negotiators stated that some schools tell borrowers that a high school diploma is not a requirement for title IV student aid, or that the borrower will be able to earn a high school diploma through the program for which the borrower is taking out the student loan, so the borrower should answer “Yes” to the high school graduation question on the FAFSA. Non-Federal negotiators stated that some schools encourage borrowers to obtain the services of a third party that will provide them with what appears to be a legitimate high school diploma. These borrowers often do not understand that the “high school diploma” provided by the third party is worthless.

Many non-Federal negotiators were supportive of the Department’s efforts to provide relief for borrowers who have been victimized in this way. Some of the non-Federal negotiators, while supportive of this proposal, noted that borrowers themselves may provide false information to the schools regarding the borrower’s high school graduation status. Unless the school investigates the borrower’s claim to be a high school graduate, for instance by requesting transcripts, which are harder to falsify, the school may unknowingly falsely certify the borrower’s eligibility.

To address these situations, the Department proposed during the negotiated rulemaking to include the requirement in proposed §685.215(a)(1)(i)(A) that the borrower “reported” not having a high school diploma or its equivalent. If the borrower informed the school that the borrower was not a high school graduate, and the borrower also did not satisfy the alternative to high school graduation eligibility criteria, but the school still certified the borrower’s eligibility for title IV aid, the borrower would qualify for a false certification discharge.

Under proposed §685.215(a)(1)(ii), a borrower would qualify for a false certification discharge if the borrower was not a high school graduate, and the school certified the borrower’s eligibility based on falsified high school graduation status or based on a high school diploma falsified by the school or a third party to which the school referred the borrower. The reference in proposed §685.215(a)(1)(ii)(B) to cases in which a school refers a borrower to a third party to obtain a false high school diploma would not refer only to a formal referral relationship between the school and the third party. An informal relationship involving any level of contact between the school and the third party would also qualify under the proposed regulations. A school would be considered to have “referred the borrower” to the third party in any instance in which the school advised or encouraged a borrower to obtain a false high school diploma from the third party.

The proposed revision to §685.215(a)(1)(iv) would clarify that this section refers to a situation in which a borrower failed to meet State requirements for employment in the occupation for which the training program was supported or the loan was intended. These State requirements would not necessarily have to be imposed by State statutes; they could be requirements established through State regulations or other limitations established by the State. The Department considered using other employment standards, such as Federal standards, or standards established by non-governmental professional associations. However, we were unable to find examples of Federal standards for particular professions, other than standards specifically for employment in the Federal government. The Department believes that employment standards established by professional associations could vary, and that it would not be practical to require schools to determine which professional association standards to use.

Some of the non-Federal negotiators recommended including limited English proficiency (LEP) as one of the characteristics that would disqualify a borrower from working in a particular profession and serve as the basis for a false certification loan discharge. We reviewed this proposal, but determined that it would not be practical to determine a borrower’s English language proficiency at the time the borrower enrolled in the program. While a student’s score on the Test of English as a Foreign Language (TOEFL) is a generally accepted indicator of English language proficiency, many schools do not administer this test, the TOEFL is not required for all academic programs, and the scores required to demonstrate sufficient proficiency differ between schools. Moreover, the TOEFL is not intended to measure an individual’s language proficiency for any particular profession.

Non-Federal negotiators recommended that the Department require schools to certify an LEP student’s ability to successfully complete a postsecondary program by either administering an evaluative test such as the TOEFL; providing the student with complete instruction, instructional materials, and exams in her or his native language; or providing specific and sufficient accommodation through an approved English as a Second Language component. The Department expressed concern that such a limitation could impede access to postsecondary education for some LEP students. The Department also noted that certification of LEP students for Direct Loans does not constitute false certification of eligibility for title IV, HEA program funds. Non-Federal negotiators recommended that false certification discharge apply in cases in which an LEP student is enrolled in a program for a profession that requires English proficiency, or an LEP student is told that instruction will be offered in the student’s first language or that the student will be provided English as a Second Language courses, but after the student takes out a Direct Loan and enrolls, no such instruction is provided. However, the Department noted that these are examples of misrepresentation, which would fall under the borrower defenses regulations.

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 for a borrower to submit an application for discharge on “a form approved by the Secretary,” which more accurately reflects current practice. The proposed changes to redesignated §685.215(c)(8) would add, as an example of information that the Department may use to grant a false certification discharge without an application, evidence that a school has falsified the SAP of its students. Although the Department may already do this under the language in current §685.215(c)(7), we believe that it is helpful to specifically address such cases in the regulatory language. This change would put schools on notice that, if the Department learns of a school falsifying SAP through a program review or an audit, the Department has the authority to independently grant false certification discharges to affected borrowers at that school.

Some of the non-Federal negotiators recommended that we also allow an individual borrower to apply for a false certification discharge if the borrower believes that the school falsified the borrower's SAP. We examined this proposal, and determined that it would be impractical. Schools have a great deal of flexibility both in determining and implementing SAP standards. There are a number of exceptions under which a borrower who fails to meet SAP can continue to receive title IV loans. As one of the non-Federal negotiators pointed out, borrowers who are in danger of losing title IV eligibility due to the failure to meet SAP standards often request reconsideration of the SAP determination. Schools often work with borrowers in good faith efforts to attempt to resolve the situation without cutting off the borrowers' access to title IV assistance. We do not believe that a school should be penalized for legitimate attempts to help a student who is having difficulty meeting SAP standards, nor do we believe a student who has successfully appealed a SAP determination should then be able to use that initial SAP determination to obtain a false certification discharge of his or her student loans. In addition, we believe it would be very difficult for an individual borrower to sufficiently demonstrate that a school violated its own SAP procedures. Given these considerations, we propose to limit false certification discharges based on falsification of SAP to discharges based on "information in the Secretary's possession." Such information would include, for example, findings from program reviews, audits, or other investigations.

The proposed revisions to §685.215(d)(3) would provide more transparency to the process for granting false certification discharges. For example, under proposed §685.215(d)(3), when the Department denies a false certification discharge request, we would explain the reasons for the denial to the borrower, provide the borrower with the evidence that the decision was based on, and provide the borrower the opportunity to provide additional information which the Department would evaluate. This proposed new language was suggested by one of the non-Federal negotiators, and was generally supported by all of the members of the negotiating committee.

In addition to the revisions that we are proposing in this NPRM, the non-Federal negotiators submitted recommendations to the Department for additional revisions to the false certification regulations. These included recommendations to extend the revisions to the FFEL regulations as well as the Direct Loan regulations; to allow false certification discharges in cases when a program that the borrower is enrolled in fails to meet title IV eligibility requirements (although the program was participating in the title IV, HEA programs at the time the loan was made); and to require active confirmation when a school notifies a borrower that an additional loan was made under the borrower's previously executed Master Promissory Note (MPN), to address issues of possible forgery of electronic signatures on an MPN.

The Department declined to accept these recommendations. We are not proposing to extend the revisions to the FFEL Program because no new loans are being made in the FFEL Program, and we cannot apply these changes retroactively.

False certification discharges are based on a school falsely certifying a borrower's eligibility. They do not apply in instances that do not concern a personal characteristic or qualification of the borrower, such as ineligibility of the school or the program offered by the school. See 59 FR 22469 (April 28, 1994).

The recommendations regarding active confirmation and use of the MPN relate more to the way Direct Loans are awarded and disbursed than to the false certification requirements, and go beyond the scope of this regulatory action.

Direct Consolidation Loans (§685.220)

Statute: Section 455(g) of the HEA provides that the loan types listed in section 428C(a)(4) may be consolidated into a Direct Consolidation Loan. Section 428C(a)(4)(E) of the HEA provides that loans made under part E of title VIII of the Public Health Service Act are eligible to be consolidated into a Federal Consolidation Loan under the FFEL Program. Loans made under part E of title VIII of the Public Health Service Act include both Nursing Student Loans and Nurse Faculty Loans.

Current Regulations: Current §685.220(b)(21) specifies that nursing loans made under subpart II of part B of title VIII of the Public Health Service Act may be consolidated into a Direct Consolidation Loan.

Current §685.220(d)(1)(i) states that a borrower may obtain a Direct Consolidation Loan if the borrower consolidates at least one Direct Loan or FFEL Loan. If the borrower has certain other eligible loan types such as a Perkins Loan or a loan issued by the U.S. Department of Health and Human Services (HHS), the borrower can only include these loans in a Direct Consolidation Loan if the borrower also includes at least one Direct or FFEL loan. Under §685.220(b), loans issued by HHS that may be consolidated into a Direct Consolidation Loan, if the borrower also includes at least one Direct or FFEL loan, include Health Professions Student Loans (HPSL), and Loans for Disadvantaged Students (LDS), made under subpart II of part A of title VII of the Public Health Service Act, Health Education Assistance Loans (HEAL), and Nursing Loans made under subpart II of part B of title VII of the Public Health Service Act.

Proposed Regulations:

Consolidation of Nursing Loans

The proposed regulations would revise §685.220(b)(21) to provide that nursing loans made under part E of title VIII of the Public Health Service Act may be consolidated into a Direct Consolidation Loan.

Consolidation of Eligible Loans

We propose to remove current §685.220(d)(1)(i) to eliminate the requirement that a borrower must consolidate at least one FFEL or Direct Program Loan. This would allow a borrower to consolidate under the Direct Loan Program, if the borrower had any of the eligible loans listed in §685.220(b).

Reasons:

Consolidation of Nursing Loans

The proposed change is needed to conform §685.220(b)(21) to the statutory language in section 428C(a)(4)(E) of the HEA, which allows for the consolidation of both Nursing Student Loans and Nurse Faculty Loans. The current regulatory reference to nursing loans "made under subpart II of part B of title VIII of the Public Health Service Act" includes Nursing Student Loans, but not Nurse Faculty Loans. The current regulatory language reflects earlier statutory language that was subsequently amended.

Consolidation of Eligible Loans

The proposed change to remove current §685.220(d)(1)(i) would eliminate the requirement that a borrower must have a Direct Program or FFEL loan to consolidate. As a result, other loan types listed in §685.220(b), such as Perkins Loans and certain loans issued by HHS, would also be allowed to access consolidation, even if the borrower did not also consolidate a Direct Program or FFEL loan.

The proposed change is necessary to be consistent with sections 451(b)(2) and 455(a)(1) of the HEA, which provide that, unless otherwise specified, Direct Loans are to have the same terms, conditions, and benefits as FFEL Loans. 20 U.S.C. 1087a(b), 1087e(b)(1). Under the FFEL Program, certain loans issued by HHS (HPSL, LDS, HEAL, and Nursing loans) and Federal Perkins loans were considered eligible student loans for consolidation, without any added requirement that the borrower also consolidate at least one FFEL Loan. 20 U.S.C. 1078-3(a)(4)(B), (D); 34 CFR §682.100(a)(4). The authority for lenders to make FFEL Consolidation Loans expired on June 30, 2010, under section 428C(e) of the HEA, 20 U.S.C. 1078-3(e). Since current §685.220(d)(1)(i) does not allow Federal Perkins loan borrowers and borrowers of loans issued by HHS as listed in §685.220 to obtain a Direct Consolidation Loan, unless they also consolidate either a Direct or FFEL loan, Federal Perkins and HHS student loan borrowers who do not also have at least one Direct Loan or FFEL Loan do not currently have access to consolidation. As a result, these borrowers are not receiving the same terms, conditions and benefits in the Direct Loan program as in the FFEL Program.

To correct this situation, the Department proposes to allow borrowers to obtain a Direct Consolidation Loan regardless of whether the borrower is also seeking to consolidate a Direct Program or FFEL loan, if the borrower has a loan type identified in §685.222(b).

<u>Agreements Between an Eligible School and the Secretary for Participation in the Direct Loan Program (§685.300)</u>

<u>Statute</u>: Section 454(a)(6) of the HEA, 20 U.S.C. 1087d(a)(6), provides that schools enter into Direct Loan Participation Agreements that include provisions needed to

protect the interests of the United States and promote the purposes of the Direct Loan Program.

Current Regulations: Section 685.300 states the requirements for a school to participate in the Direct Loan Program. First, the school must meet the requirements for eligibility under the HEA and applicable regulations. Second, the school must enter into a written program participation agreement with the Secretary. Under the agreement, the school agrees to comply with the HEA and applicable regulations. Paragraph (b) of §685.300 lists several specific provisions of the program participation agreement.

Proposed Regulations: Proposed §685.300(d), (e), (f), (g), (h) and (i) would add specific provisions to the Direct Loan program participation agreement related to student claims and complaints based upon acts or omissions[44] of a school that are related to the making of a Federal loan or the provision of educational services for which the loan was provided and that could also form the basis of borrower defense claims under §685.206(c) or proposed §685.222.

Specifically, proposed §685.300(d), (e), (f), (g), (h) and (i) would provide that--

[44] Unless otherwise noted, we use the phrases "borrower defense-type claims" or "potential borrower defenses" to refer to such complaints or disputes.

- A school may not require any student to pursue a complaint based on such acts or omissions through an internal institutional process before the student presents the complaint to an accrediting agency or government agency authorized to hear the complaint;

- The school may not obtain or attempt to enforce a waiver of or ban on class action lawsuits regarding borrower defense-type claims;

- The school may not compel the borrower to enter into a pre-dispute agreement to arbitration of a borrower defense-type claim, or attempt to compel a borrower to arbitrate such a claim by virtue of an existing a pre-dispute arbitration agreement;[45] and

- The school must notify the Secretary of the initial filing of such a claim, whether in arbitration or in court, and must provide copies of the initial filing, certain subsequent filings, and any decisions on such claims.

Reasons: Through this rulemaking, the Department is proposing to address the procedures to be used for a borrower to establish a borrower defense based on acts or

[45] Unless otherwise noted, we use the phrase "pre-dispute arbitration agreement" to refer to agreements providing for arbitration of any future disputes between the parties, regardless of the label given the agreement, its form or its structure. These could take the form of stand-alone agreements, as well as such an agreement that is included within, annexed to, incorporated into, or otherwise made a part of a larger agreement between the parties.

omissions of a school related to the making of a Direct Loan or the provision of educational services for which the Direct Loan was provided, and the effect of borrower defenses on institutional capability assessments, among other things. 80 FR 63479. For disputes involving claims that may be potential borrower defenses, we propose to add to the Direct Loan program participation agreement provisions relating to schools’ current use of certain dispute resolution procedures. For the reasons explained here, these procedures, individually and collectively, can:

- Affect whether institutions are held accountable for the acts and omissions that give rise to borrower defense claims;
- Make it more likely that the costs of losses from those acts or omissions will be passed on to the taxpayer;
- Reduce the incentive for institutions to engage in fair and ethical business practices rather than practices that give rise to borrower defense claims; and
- Frustrate or reduce the effectiveness of the Department’s proposed processes for submitting and determining the validity of borrower defense claims.

Accordingly, proposed §685.300(d) through (i), individually and collectively, are designed to help ensure that the proposed borrower defense and institutional accountability regulations will achieve their intended goals--to protect students, the Federal government, and taxpayers against risks from potential borrower defenses and potential school liabilities.

We believe that to protect students, taxpayers, and the Federal government from the risk of loss arising from borrower defense claims based on the acts or omissions of the school, financial responsibility for these risks should be placed on the party whose conduct gives rise to the risk. To do so, borrowers must be free to present these claims to an authority well-situated to consider the merits of their claims and provide effective recourse directly against the school. Accordingly, we propose regulatory changes to §685.300 that would support these objectives in separate but complementary ways. In each case, the proposed regulations would enhance the opportunities for borrowers with borrower defenses to obtain relief directly from schools and help ensure that schools are held accountable for their acts or omissions that give rise to borrower defenses.

Specifically, for Direct Loan participants, we propose to:

- Prohibit the use of class action waivers in order to, among other things, permit the aggregation of claims that may reflect widespread wrongdoing for which institutions might not otherwise be held accountable;

- Bar the use of mandatory pre-dispute arbitration agreements, in order to, among other things, prevent institutions from suppressing individual student complaints and shifting the financial risk associated with institutional wrongdoing to the Department and the taxpayers;

- Require institutions to modify existing arbitration agreements or notify individuals who have already executed arbitration agreements that the institution will not attempt to enforce an existing arbitration agreement in a manner prohibited by the regulations; and

- Require institutions to inform the Secretary of the assertion and resolution of potential borrower defense claims to enable the Secretary to monitor compliance with these requirements, to assess the nature and incidence of acts or omissions that form the grounds on which claims are asserted, to better focus corrective or enforcement actions, and to disseminate useful information about the nature and frequency of such claims and the judicial and arbitral outcomes of these claims.

We further propose in §685.300(d), regarding exhaustion of internal complaint procedures, to prohibit the school from requiring or attempting to require students to exhaust a school's internal complaint process before contacting or communicating a grievance with the school's accreditor or government agencies – including this Department - with authority over the school.

In proposing these regulatory changes, the Department is responding to comments made during negotiated rulemaking by the public and by non-Federal negotiators, and to a proposal submitted by a negotiator, which was supported by a number of other negotiators, in each case relating to the use of arbitration by schools. Proposals the Department received both from non-Federal negotiators and from the public on this issue are available at www2.ed.gov/policy/highered/reg/hearulemaking/2016/index.html.

During the negotiated rulemaking, we sought comment on two alternative options. Both options would bar the use of any pre-dispute arbitration agreements that include a waiver of the student’s right to bring or participate in a class action lawsuit for claims that would constitute borrower defenses within the scope of §685.206(c) and proposed §685.222--in other words, claims related to the making of the Direct Loan or the provision of educational services for which the loan was intended. Both options would also require the school to submit copies of initial filings of any such claims and each ruling, award, or decision on the claims to the Secretary. Proposed Option A would prohibit schools from requiring students to pursue complaints, grievances, or disputes for such claims through an internal complaint process before presenting the complaint, grievance or dispute to an accrediting agency or government agency. Option A would allow the school to require the arbitration of claims asserted in a class action only if a court were to deny class certification or dismiss the class claims. This option would further require schools to ensure that the arbitration included certain procedural protections to increase the transparency and fairness of the arbitration proceeding. Option B would include provisions regarding class action waivers and submission of filings to the Secretary described above, but would only have barred the use of pre-dispute arbitration agreements.

Nearly all of the negotiators supported the proposed Option B. Many negotiators stated that by requiring students to arbitrate disputes, arbitration clauses function to suppress meritorious student complaints. They also noted that many schools' arbitration agreements contain confidentiality clauses. Since arbitration records are not public like court records, the negotiators noted that potential student claimants and their representatives generally may not have access to prior pleadings, awards, or arbitrator decisions. Negotiators also noted that many school enrollment agreements contain bans on class claims or have provisions with that effect, which prevents evidence of widespread patterns and unlawful practices to come to the attention of students, the public, and the Department. One negotiator, however, stated that the Department's proposal was outside the notice of issues to be considered, and thus beyond the scope of the issues for the rulemaking, and was concerned that neither proposed Option A or Option B fit within the U.S. Supreme Court precedent regarding arbitration. However, the negotiator stated that of the two proposed options, Option B was preferred.

As opposed to the options that were proposed by the Department at the negotiated rulemaking, in this NPRM, the

Department proposes adding provisions that we believe would similarly prevent schools' use of internal complaint processes as a barrier to students' communication of such issues to accreditors or government agencies; ban the use of class action waivers by schools for potential borrower defense claims; prohibit mandatory pre-dispute arbitration agreements; and create transparency regarding the conduct and outcomes of arbitration proceedings. After evaluating the available research on arbitration and the concerns of all of the negotiators at the table, the Department has chosen to propose a modified version of Option B in this NPRM.

The Direct Loan program participation agreement

The Department proposes to add provisions addressing the use of class action waivers, pre-dispute arbitration agreements, submission of filings, and internal complaint processes to the Direct Loan program participation agreements. Section 452(b) of the HEA states, "No institution of higher education shall have a right to participate in the [Direct Loan] programs authorized under this part [part D of title IV of the HEA]." 20 U.S.C. 1087b(b). Rather, an institution may participate only by supplying an application containing "such information and assurances as the Secretary may require." 20 U.S.C.

1087c(b)(1). Further, section 454 of the HEA directs that a school may participate in the Direct Loan Program only by virtue of a "participation agreement." 20 U.S.C. 1087d. Section 454 further states that such program participation agreement shall include, among other things, "such other provisions as the Secretary determines are necessary to protect the interests of the United States and promote the purposes of this part [Part D of title IV of the HEA, describing the Direct Loan Program]." 20 U.S.C. 1087d(a)(6). The Direct Loan Agreement described in section 454 of the HEA is now included as a separate component of the program participation agreement required under section 487(a) of the HEA. 20 U.S.C. 1094(a). The purpose of the Direct Loan Program is to provide loans to students and parents to finance the attendance of students in postsecondary education. Loans are not grants, and are expected to be repaid. The same part of the HEA, part D, also includes the borrower defense provision, section 455(h) of the HEA, which directs the Department to "specify in regulations which acts or omissions of an institution . . . a borrower may assert as a defense to repayment" of a Direct Loan. 20 U.S.C. 1087e(h).

While section 455(h) of the HEA authorizes the Department to establish grounds for a borrower to avoid repaying a Direct Loan, we believe that the overall "purpose" of the Direct Loan Program is to make loans that will then be repaid. To be repayable, the loans must be enforceable obligations of the borrowers. Acts and omissions by schools that give a borrower grounds for avoiding repayment of a Direct Loan thereby frustrate the achievement of the primary objectives of the Federal loan program--to both finance education and obtain repayment. By impeding the ability of borrowers to obtain effective relief directly from the school, the practices we propose to prohibit in §685.300(d) through (ii) instead encourage these borrowers to raise their claims against the school to the Department as reasons for not repaying their loans, and in so doing, increase the financial risk to the taxpayer from the claims themselves.

Class action waivers

In considering class action waivers, we consider the effect that such waivers can and have already had on the interests of taxpayers and the achievement of the purposes and objectives of the Direct Loan Program. Among other things, the Department has reviewed the Notice of Proposed Rulemaking recently issued by the CFPB (hereinafter the "CFPB Arbitration Agreements NPRM") and considers the analysis and proposals made there as they bear on these assessments for the Direct Loan Program.[46] The CFPB has been charged by statute with evaluating the use of mandatory, pre-dispute arbitration agreements. 12 U.S.C. 5518(a). The CFPB conducted a comprehensive three-year study of those agreements' effect on consumers, and has made a preliminary determination that a ban on the use of mandatory pre-dispute arbitration agreements regarding covered consumer financial products and services to preclude assertion of claims through class action lawsuits would benefit consumers, serve the public interest, and be consistent with its study.[47] The CFPB stated that its study, together with the CFPB's experience and expertise, resulted in the CFPB's notice of proposed rulemaking regarding class action waivers. The CFPB stated the following "preliminary conclusions":

> (1) The evidence is inconclusive on whether individual arbitration conducted during the Study period is superior or inferior to individual litigation in terms of remediating consumer harm; (2) individual dispute resolution is insufficient as the sole

[46] Consumer Financial Protection Bureau, Arbitration Agreements, 80 FR 32830 (May 24, 2016).

[47] CFPB, Small Business Advisory Review Panel for Potential Rulemaking on Arbitration Agreements, Oct. 7, 2015 (SBREFA Outline)) at 4.

> mechanism available to consumers to enforce contracts and the laws applicable to consumer financial products and services; (3) class actions provide a more effective means of securing relief for large numbers of consumers affected by common legally questionable practices and for changing companies' potentially harmful behaviors; (4) arbitration agreements block many class action claims that are filed and discourage the filing of others; and (5) public enforcement does not obviate the need for a private class action mechanism.

CFPB Arbitration Agreements NPRM, 81 FR 32830, 32855.

The CFPB identified several features of class actions in the consumer financial services markets that we consider applicable to the postsecondary education market. First, the CFPB noted that class actions facilitate relief for individual consumers because they "provide a mechanism for compensating individuals where the amounts at stake for individuals may be so small that separate suits would be impracticable."[48] Second, class actions "strengthen incentives" for industry members to "engage in robust

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[48] CFPB Arbitration Agreements NPRM, at 81 FR 32833; see also SBARP, at 15.

compliance and customer service on an ongoing basis."[49] While government agencies "can and do bring enforcement actions against companies that cause injury to large numbers of consumers, government resources to pursue such lawsuits are limited."[50] Thus, the CFPB preliminarily concludes, "Public enforcement is not a sufficient means to enforce consumer protection laws and consumer financial contracts."[51] As the CFPB stated, "When companies can be called to account for their misconduct, public attention on the cases can affect or influence their individual business practices and the business practices of other companies more broadly."[52] Moreover, the CFPB preliminarily finds that "exposure to consumer financial class actions creates incentives that encourage companies to change potentially illegal practices and to invest more resources in

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[49] Id. As the CFPB noted in its study, in the 46 consumer class actions and six individual suits filed by consumers in which defendant companies obtained orders compelling arbitration, in only 12 instances did a consumer then pursue arbitration, and none of the 12 were class arbitrations. CFPB, ARBITRATION STUDY, March 2015, §6.7.1.

[50] Id. As the CFPB also noted in its study, government enforcement authorities brought some 1150 administrative or judicial enforcement actions during the 2010-2012 survey period, of which some 133 address the same conduct as that on which consumers had brought a class action lawsuit; in 71 percent of these instances, the private class action preceded the government enforcement action. CFPB ARBITRATION STUDY, March 2015, §9.1.

[51] CFPB Arbitration Agreements NPRM, at 81 FR 32860.

[52] CFPB Considers Proposal to Ban Arbitration Clauses that Allow Companies to Avoid Accountability to Their Customers, Oct. 7, 2015, available at www.consumerfinance.gov/newsroom

compliance in order to avoid being sued."[53] Based on its comprehensive study of the use of pre-dispute arbitration agreements in the financial services sector, the CFPB now proposes to bar the use of arbitration agreements to preclude the pursuit of class actions, which includes the use of class action waivers in arbitration agreements--agreements that require consumers in the financial services markets to agree to forego class action.[54]

The proposed CFPB rule describes the financial services markets to which the CFPB rule would apply.[55] We believe the findings and reasoning of the CFPB support the protections for Direct Loan borrowers of the kind we propose here. Agreements that bar relief by class action lawsuits for potential borrower defenses remove the risk to a school that the threat of such a class action would pose and, thus, they eliminate the financial incentive for the school to comply with the law that such a risk of a class action would otherwise create.[56] By doing so, class action

[53] CFPB Arbitration Agreements NPRM, at 81 FR 32864.

[54] www.consumerfinance.gov/about-us/newsroom/consumer-financial-protection-bureau-proposes-prohibiting-mandatory-arbitration-clauses-deny-groups-consumers-their-day-court/ CFPB Arbitration Agreements NPRM, 81 FR 32830, 32925, to be codified at 12 CFR 1040.4.

[55] See CFPB Arbitration Agreements NPRM, 81 FR 32830, 32925, to be codified at 12 CFR 1040.3 (describing covered services); See also: SBREFA Outline at 22.

[56] The Department makes no distinction between class action waivers included in arbitration agreements and such waivers established

waivers impede borrowers from obtaining compensatory relief for themselves, and further prevent borrowers from obtaining injunctive relief to compel a school, in a timely manner, to desist from the conduct that caused them injury and could continue to cause other borrowers injury in the future. Class action waivers effectively allow a school to perpetuate misconduct with much less risk of adverse financial consequences than if the school could be held accountable in a class action lawsuit.

Recent history demonstrates the need to address bans by postsecondary institutions on class actions for potential borrower defense claims. Corinthian Colleges included explicit class action waiver provisions in enrollment agreements, and used those, with mandatory pre-dispute arbitration clauses, to resist class actions by students.[57] Government investigations established that Corinthian had for years engaged in widespread misrepresentations and other abusive conduct. In April 2015, the Department levied a $30 million fine against Heald, a chain owned by Corinthian, for misrepresenting its

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otherwise, such as in an enrollment agreement that does not include any reference to or agreement regarding arbitration. The negative effects of such waivers discussed here hold regardless of where the waiver is established.

[57] See, e.g., Montgomery v. Corinthian Colleges, C.A. No. 11-C-365 (N.D.Ill. Mar. 25, 2011); Ferguson v. Corinthian Colleges, Inc., 773 F.3d 928 (9th Cir. 2013).

placement rates, but several days later, Heald and the remaining Corinthian-owned schools closed, and Corinthian filed for bankruptcy relief. The State of California sued Corinthian in September 2013, and obtained a $1.1 billion judgment against the company only in March 2016, after the company had filed for bankruptcy relief. The CFPB sued Corinthian in September 2014, and obtained a $531 million judgment against the company only in October 2015--well after Corinthian had become insolvent and filed in bankruptcy. None of these government actions actually achieved affirmative recovery for Corinthian Direct Loan borrowers.[58] Yet in 2012, a class of students attending Corinthian Colleges, including Heald College and Everest Institute, Miami, had filed class actions against the schools for students who attended the schools since 2005 (Everest) or 2009 (Heald), for "misrepresenting the quality of its education, its accreditation, the career prospects for its graduates, and the cost of education." Ferguson v. Corinthian Colleges, 733 F.3d 928 (9th Cir. 2013). Corinthian defended by claiming that the arbitration clause in their enrollment agreements barred

[58] This Department and the CFPB did achieve substantial relief in 2015 for many Corinthian students who had obtained private loans, but only through negotiations with the Educational Credit Management Corporation, which acquired some of the Corinthian schools.

relief in a class action, and in an August 2013 ruling the Ninth Circuit Court of Appeals agreed. Id. Another class action filed in 2011 in Illinois against Corinthian Colleges by students, alleging deception about placement rates, was similarly barred. Montgomery v. Corinthian Colleges, C.A. No. 11-C-365 (N.D.Ill. Mar. 25, 2011). Other Corinthian students unsuccessfully pursued relief through individual and class actions against Corinthian schools, and, in each instance, Corinthian successfully opposed the suits and obtained rulings compelling individual arbitration of the student claims.[59] In yet another case, Corinthian opposed recovery by a student who had been compelled to arbitrate, and had obtained a favorable award from the arbitrator that granted relief not only to the individual student but to a class of students; Corinthian argued, and the court agreed, that the arbitration agreement barred even class arbitrations. Reed v. Fla. Metropolitan Univ., 681 F.3d 630 (5th Cir. 2012),

[59] Eakins v. Corinthian Colleges, Inc., No. E058330, 2015 WL 758286 (Cal. Ct. App. Feb. 23, 2015); Okwale v. Corinthian Colleges, No. 1:14-CV-135-RJS, 2015 WL 730015 (D. Utah Feb. 19, 2015); Kimble v. Rhodes College, No. C-10-5786, 2011 WL 2175249 (N.D. Cal. June 2, 2011); Miller v. Corinthian Colleges, 769 F.Supp.2d. 1336 (D. Utah 2011); Rodriguez v. Corinthian Colleges, Inc., No. 07-CV-02648-EWNMJW, 2008 WL 2979505 (D. Colo. Aug. 1, 2008); Ballard v. Corinthian Colleges, Inc., No. C06-5256 FDB, 2006 WL 2380668 (W.D. Wash. Aug. 16, 2006); Anderson v. Corinthian Colleges, Inc., No. C06-5157 FDB, 2006 WL 2380683 (W.D. Wash. Aug. 16, 2006).

abrogated by Oxford Health Plans LLC v. Sutter, 133 S. Ct. 2064, 186 L. Ed. 2d 113 (2013).

If the student class actions had been able to proceed, the class actions could have compelled Heald College and the Corinthian Colleges, generally, to provide financial relief to the students and to change their practices while Corinthian was still a viable entity. Instead, impacted borrowers with Direct Loans from attendance at any of the Corinthian Colleges will only be able to obtain relief by raising the schools' misconduct as a defense to their Federal loans through the Department's current borrower defense process under §685.206(c).[60] As of the close of March 2016, the Department had granted discharge relief in the amount of $42,318,574 to 2,048 Direct Loan borrowers making claims related to Heald, Everest Institute, and Wyotech.[61] As of June 1, the Department had received more than 23,000 claims relating to Corinthian and other schools.

Similarly, the inability of borrowers to bring class actions removed the deterrent force that the threat of

[60] Because Corinthian required pre-dispute arbitration agreements, students were unable to successfully pursue individual lawsuits against the schools.

[61] Third Report of the Special Master for Borrower Defense to the Under Secretary, March 25, 2016, available at https://www2.ed.gov/documents/press-releases/report-special-master-borrower-defense-3.pdf.

being sued in a class action posed to other industry members during this same period. Federal and State reviews of for-profit school practices over the past five years, recounted, for example, in the Department's notice of proposed rulemaking for Program Integrity: Gainful Employment, 79 FR 16426 (March 25, 2014), show numerous instances in which major for-profit schools engaged in deceptive acts of the kind on which students were attempting to sue. However, during that same period, courts regularly rebuffed the students' attempts by compelling the students to submit their claims to arbitration. See, e.g., Rosendahl v. Bridgepoint Educ., Inc., No. 11CV61 WQH WVG, 2012 WL 667049 (S.D. Cal. Feb. 28, 2012). Had students been able to bring class actions against Corinthian or other industry members, it is reasonable to expect that other schools would have been motivated to change their practices to avoid facing the risk of similar suits.

Class action bans eliminate this incentive. By doing so, these agreements increase the likelihood that borrowers who have such claims will present them solely to the Department as defenses to repayment of their taxpayer-funded Federal loans. The Department's borrower defense process gives limited relief for borrowers, providing only discharge of the borrower's Federal loan obligation, and potential recovery of past payments made to the Secretary, rather than compensation in damages from the school for his or her losses. Recoveries through the court system --for the cost of the loan itself--would eliminate any need to seek relief from the Department--and the taxpayers. In addition, recoveries in damages may include other losses the borrower incurred as well, such as the tuition an individual privately paid or the value of the time spent at the institution. In the Department's experience, borrower defense claims are presented to the Department well after the underlying act or omission that gave rise to the claim has occurred, at a point at which the school may well have ceased operations and there may be less reliable evidence available to borrowers. That shifts the financial risk of a school's insolvency to the taxpayer, rather than to the school as the responsible party.

We believe that class action lawsuits not only provide a vehicle for addressing a multitude of relatively small claims that would otherwise not be raised--or raised only as borrower defense claims--but create a strong financial incentive for both a defendant school and other similarly situated schools to comply with the law in their business operations. Pre-dispute arbitration agreements coupled with class action waivers eliminate this incentive by preventing the aggregation of small claims that may reflect widespread wrongdoing. We believe that banning class action waivers as they pertain to potential borrower defense claims would promote direct relief to borrowers from the party responsible for injury, encourage schools' self-corrective actions, and, by both these actions, lessen the amount of financial risk to the taxpayer in discharging loans through the defense to repayment process.

Pre-dispute arbitration agreements

Because pre-dispute arbitration agreements bar the student from bringing an individual lawsuit against the school for relief, these agreements pose some of the same risks to borrowers and the taxpayer as those posed by class action waivers. Even if the borrower were not contractually foreclosed from pursuing a class action suit, Federal and State rules impose requirements on class actions that may well prevent particular borrowers from bringing and successfully maintaining a class action. For such borrowers, mandatory pre-dispute arbitration agreements bar them from seeking judicial relief. .[62] The

[62] Fed. R. Civ. Proc. 23 requires, for example, that questions of law or fact common to members of the class predominate over issues affecting only individual members. Fed. R. Civ. P. 23(b)(3). Courts

ability to compel arbitration allows the school to bar the individual from bringing a suit, either individually or, by joinder, with other borrowers, and thereby avoid the publicity and financial risks described earlier that follow from class actions. Similarly, foreclosing individual or joinder actions eliminates, for other industry members, the risk that a well-publicized lawsuit will inspire similar individual or joinder actions against those schools, and therefore dampens or eliminates the incentive for other schools to comply with the law in their business dealings with their student customers. In addition, a well-publicized lawsuit is more likely to attract the attention and risk of compensatory or prophylactic enforcement action by this Department and other government agencies.

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have not infrequently denied class certification for student loan borrowers raising class action fraud claims against schools:

> When students who seek to be named as plaintiffs in a proposed class action may have considered a variety of factors in deciding to enroll in a school alleged to have defrauded them, absent are typical and predominant questions whether such plaintiffs relied upon misrepresentations made by the school in deciding to enroll therein; class certification must therefore be denied. Rodriguez v. McKinney, 156 F.R.D. 112, 116 (E.D.Pa. 1994) (no predominance); Graham v. Sec. Sav. & Loan, 125 F.R.D. 687, 691 n. 4 (N.D.Ind. 1989) (no typicality), aff'd sub nom. Veal v. First Am. Sav. Bank, 914 F.2d 909 (7th Cir. 1990); see Torres v. CareerCom Corp., 1992 WL 245923, at *5 (E.D.Pa. Sept. 18, 1992) (no predominance); see generally Seiler Jr. v. E.F. Hutton & Co., 102 F.R.D. 880, 890 (D.N.J. 1984) (no typicality).

Morgan v. Markerdowne Corp., 201 F.R.D. 341, 348 (D.N.J. 2001).

Foreclosing individual student lawsuits removes this risk, much like class action waivers. Accordingly, mandated arbitration can be expected to frustrate the Federal and Direct Loan interests for the same reasons, though to a lesser degree, than class action waivers.

We note that the CFPB considered a ban on mandatory pre-dispute arbitration agreements, and in light of its mandate, preliminarily found the evidence to be "inconclusive whether individual arbitration conducted during the Study period is superior or inferior to individual litigation in remediating consumer harm. . ." 81 FR 32830, 32855, 32921. The CFPB did acknowledge that a ban on pre-dispute arbitration agreements would "give[ ] providers [of financial services the] same incentives to comply with the law as the proposed rule [banning class action waivers]. 81 FR 32830, 32921. Section 1028(b) of the Dodd-Frank Act provides that the mandate of the CFPB with respect to any regulation the CFPB adopts regarding arbitration is to determine whether, it would be in the "public interest and for the protection of consumers" to "prohibit or impose limitations on the use of an agreement . . . for a consumer financial product or service providing for arbitration of any future dispute between the parties.

. .” 12 U.S.C. 5518(b). Also, under section 1028(b), “the findings in such rule shall be consistent with the study.”

The Department proposes to act under a different mandate, under section 454(a)(6) of the HEA, to adopt “provisions as the Secretary determines are necessary to protect the interests of the United States and to promote the purposes of this part [the Direct Loan Program under Part D of title IV of the HEA].” 20 U.S.C. 1087d(a)(6). As discussed above, the interests at stake in this determination are not the interests of the “public” and “consumers,” but the interests of the Federal taxpayers whose funds are at risk for borrower defense claims asserted on Federal Direct Loans, and the objective at stake here, as discussed, is the successful financing of postsecondary education by providing loans repayable by current recipients for the benefit of future generations of borrowers. Because the interests at stake in regard to Direct Loans, though not inconsistent with those prescribed in the Dodd-Frank Act, are different, the Department, for the reasons stated here, considers individual litigation a better tool to protect the taxpayers’ interests in the Direct Loan program than individual arbitration.

The current regulations in §685.206(c) require Department decision makers to apply the State law applicable to the variety of causes of action that constitute borrower defenses to repayment. Under the proposed regulations, this standard would continue to apply to grievances by borrowers related to existing Direct Loans and, thus, continue to require Department officials to acquire sufficient familiarity with the law of the States to properly apply that law to thousands of borrower defense claims. The Federal interest, and the purposes of the Direct Loan program, are frustrated to the extent that schools are able to bar individuals with Direct Loan-related grievances from having those claims adjudicated by State courts, which are well-situated to adjudicate these claims under judicial procedures that assure appellate review of trial court rulings. We recognize the desirability of this option by retaining, under the proposed new standard in §685.222, the option to obtain borrower relief based on a favorable judgment of a court of competent jurisdiction, even if the judgment rests on a State law-based cause of action. By requiring institutions to permit individual borrowers access to judicial forums for claims that may constitute borrower defenses, the proposed regulations would allow borrower claims based on State law causes of action to be resolved locally, by tribunals well versed in that law, and whose decisions are subject to appellate review, unlike the far more narrow review to which arbitral awards are subject.[63] Permitting this access would promote a balanced evolution of the borrower defense standard, assuring that borrowers with meritorious State law claims will be able to pursue those in an appropriate forum, thereby reducing both the incentive for borrowers to assert their claims only through the Department process, and the burden on the Federal administrative process to continue to evaluate those claims.

Accordingly, we propose to prohibit a Direct Loan participating school from requiring the student to agree, prior to a dispute about a potential borrower defense claim, to arbitrate such a dispute. We refer to such agreements as "mandatory pre-dispute arbitration agreements" and define those agreements as "mandatory" if the school requires the student to agree to arbitrate either as part of the enrollment agreement or in any other form the student is required to execute in order to enroll or continue in school. We recognize that some pre-dispute arbitration agreements allow the consumer within a set period to affirmatively opt-out of an agreement to

[63] See 9 U.S.C. 10.

arbitrate. We include in the proposed definition that such agreements are binding unless the student affirmatively opts out of the agreement, and we invite comment on whether opt-out agreements should be considered "mandatory" agreements.

Transparency of the arbitral process and outcomes

The Department currently has little opportunity to monitor, and more importantly timely respond to, grievances that borrowers present in arbitration and even private suits, and the defenses and arguments raised by title IV participants in opposing relief. We propose, therefore, to require schools to provide us, in a timely manner, with copies of initial and certain subsequent filings in judicial or arbitral tribunals, and decisions and awards rendered in those proceedings.

The CFPB also proposes to require companies that use pre-dispute arbitration agreements to submit to the CFPB copies of initial arbitration claim filings made or received by the companies, arbitration awards, and certain other records.[64] The CFPB states that it is considering whether to make these available to the public by posting them to its Web site. The CFPB notes that this would

[64] CFPB Arbitration Agreements NPRM, 81 FR 32830, 32926 (May 24, 2016), to be codified at 12 CFR 1040.4(b)(1).

permit the CFPB and the public to monitor arbitrations on an ongoing basis and identify trends that might "indicate problematic business practices that harm consumers, particularly since many claims settle before an award is rendered."[65]

We propose the same kind of requirement here, for similar reasons. Lack of timely notice and confidentiality provisions make it difficult for the Department to discern patterns and practices that may generate borrower defense claims, involve misuse of title IV, HEA funds, or constitute misrepresentations of the kind that the HEA authorizes the Department to remedy by fines and other actions. Without knowledge of the kinds of claims and relief granted, we cannot evaluate whether further measures are needed, or whether the school is resisting class action complaints on claims that would constitute borrower defenses under the proposed regulations.

The proposed submission requirement for institutions that use arbitration agreements would enable the Department to analyze the claims that may also be potential borrower defense claims, the schools' responses, and the outcomes of the claims in arbitration. We would be able then, as

[65] SBREFA Outline, at 20

needed, to publicize both the kinds of potential borrower defense claims asserted and the decisions on those claims, and to decide whether either an immediate response or intervention was needed, or whether systemic correction action was warranted.[66] We would also be better able to evaluate the merits of a claim that a borrower later raises as a borrower defense to repayment. We believe that proposed §685.300(g), which would require schools to submit copies of filings for arbitration, responses, awards, and certain other documents within 60 days of the filing or receipt by the school, as applicable, is needed to enable the Secretary to monitor and evaluate these claims and thereby protect the interests of the United States and

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[66] Schools and other institutions participating in the title IV, HEA programs have defended suits by borrowers by contending that borrowers cannot rely on State law to redress conduct by a defendant that also violates an HEA requirement, because, they argue, enforcement of HEA requirements is vested solely in the Secretary, not in private parties. See, e.g., Sanchez v. ASA College Inc., in which the defendant school raised this argument:

> Defendants also assert that dismissal is warranted because the HEA grants the Secretary "exclusive authority" to remedy any Title IV violations and, thus, that the HEA precludes Plaintiffs' claims based on failures to comply with its provisions. (Defs. Mem. 10–15).

Sanchez v. ASA Coll., Inc., No. 14-CV-5006 JMF, 2015 WL 3540836, at *4 (S.D.N.Y. June 5, 2015). The Department, with timely notice in that instance, was able to file a statement of interest to rebut this serious misconception that a party injured by conduct that violates an HEA requirement of law cannot sue for relief for that injury in reliance on a State law that would allow a party to sue for relief for that conduct. A suit for relief based on State law in such a situation is not an attempt to find a private right of action for relief under the HEA.

promote the purposes of the Direct Loan Program.[67] In contrast, the Secretary has a far greater and more immediate interest in claims and defenses asserted in litigation, because court rulings on those assertions may construe the HEA and Department regulations, and thus have far greater effect than arbitration decisions. The issues will be joined as early as 20 days after the service of the complaint, when the defendant must answer or move to dismiss the complaint. To participate in a timely manner in litigation in which the parties assert their interpretations of the HEA and regulations, the Department needs prompt notice of these filings, in order to identify those that raise these kinds of assertions, and we propose in §685.300(h) that the school submit copies of each complaint, any counterclaim, any dispositive motion filed by either party, any ruling on a dispositive motion, and any judgment, within 30 days of receipt or filing by the school. We believe the proposed submission requirements are appropriate for the reasons stated above. However, we seek comment on whether the Department should adopt different submission, transparency, or procedural fairness

[67] The 60-day submission requirement is the same period as proposed by the CFPB for submission of arbitral filings. CFPB Arbitration Agreements NPRM, 81 FR 32830, 32926, to be codified at 12 CFR 1040.4(b)(2).

requirements, and if so, what the supporting rationale for those requirements would be, and why those other requirements would meet the objectives outlined in this section.

To the extent that a school may now include in its arbitration agreements a confidentiality provision, the rule would require the school to remove that provision or modify its use to the extent needed to make these disclosures.

Federal Arbitration Act

A negotiator asserted that the Department does not have the authority to proscribe waivers of class action litigation or use of mandatory pre-dispute arbitration agreements, citing recent Supreme Court rulings upholding contractual agreements to arbitrate that held that the Federal Arbitration Act (FAA) protects enforceable arbitration agreements and expresses a "liberal Federal policy favoring arbitration."[68] The FAA protects the validity and enforceability of arbitration agreements. Section 2 of the FAA states: "[a] written provision in any . . . contract . . . to settle by arbitration a controversy thereafter arising out of such contract . . . shall be

[68] AT&T Mobility v. Concepcion, 563 U.S. 333 (2011).

valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract." 9 U.S.C. 2. This act was intended to reverse judicial hostility to arbitration and to put arbitration agreements on an equal footing with other contracts.[69] The negotiator contended that the FAA as applied in case law barred the Department from adopting a rule that would ban either such class action waivers or mandatory pre-dispute arbitration agreements.

The Department does not have the authority, and does not propose, to displace or diminish the effect of the FAA. However, the Department has clear authority to regulate the conduct of institutions that wish to participate in the Direct Loan Program. As noted earlier, section 452(b) of the HEA states, "No institution of higher education shall have a right to participate in the [Direct Loan] programs authorized under this part [part D of title IV of the HEA]." 20 U.S.C. 1087b(b). If a school chooses to participate in the Direct Loan Program, it must enter into a Direct Loan Program participation agreement. 20 U.S.C. 1087d. Section 454(a)(6) of the HEA authorizes the Department to include in that participation agreement

[69] Id. at 342.

"provisions that the Secretary determines are necessary to protect the interests of the United States and to promote the purposes of" the Direct Loan Program. 20 U.S.C. 1087d(a)(6). We propose to adopt regulations that limit the use of arbitration agreements under this authority. We discuss earlier the reasons we consider the proposed limits on arbitration to be necessary to protect the interests of the United States and promote the purposes of the Direct Loan Program. Under proposed §685.300(f), an institution would remain free to require students to enter into mandatory pre-dispute arbitration agreements, so long as those agreements exclude any requirement to arbitrate a potential borrower defense. An institution that does not choose to accept these provisions is free to include arbitration requirements in its enrollment agreements, and to exercise its contractual rights under such agreements to compel arbitration. However, under the proposed regulations, the institution would not be permitted to obtain or exercise such agreements and continue to participate in the Direct Loan Program unless those agreements exclude any requirement that the student arbitrate a potential borrower defense claim.

Implementation for agreements regarding arbitration

Institutions that intend to mandate pre-dispute arbitration agreements or obtain class action waivers from students after the effective date of the proposed regulations will be required to include provisions in those agreements that exclude from any class action waiver or commitment to arbitrate those claims that relate to the making of the Direct Loan or the provision of educational services by the institution. The proposed regulations include provisions explaining the institution's commitment not to attempt to compel arbitration or resist class actions, as applicable, for claims that are potential borrower defense claims.

We recognize that many agreements regarding arbitration or class action waivers have already been executed and more may be executed prior to the date on which the proposed regulations may be issued in final and take effect. The proposed regulations therefore require that an institution that has such agreements not only to comply with the regulations that would bar the institution from attempting to exercise mandatory pre-dispute arbitration agreements or class action waivers regarding borrower defense-type claims, but also to either amend the agreements, or at least notify, the students who executed those agreements that the institution would not attempt to exercise those agreements in a manner proscribed by the regulations.

The institution would be required to notify students who had already executed a non-compliant arbitration or class action waiver agreement no later than the date on which the institution provides exit counseling, which provides a useful context in which to explain the change. For those who have executed a non-compliant arbitration or class action waiver but whom the institution has already provided exit counseling that included or accompanied the notice or amendment, the proposed rule would require the institution to provide the notice or amendment within 60 days of the date on which the institution receives a complaint in a lawsuit by a former student that raised borrower defense claims, or a demand for arbitration of a borrower defense claim. As proposed here, the institution would be barred from opposing such a lawsuit on the ground that the borrower had already agreed to waive class action relief or individual lawsuit for relief for such a claim. We request comment on whether the institution should provide notice to currently-enrolled students or to former students, and if so, when and to whom those notices should be required

Severability

While the Department is confident that the provisions addressing arbitration in §685.300(d), (e), (f), (g), (h) and (i) would not violate the FAA, it has carefully considered the negotiator's view, and the possibility that a court might rule that any of these provisions is invalid based on the FAA or any other reason. The Department considers the separate provisions barring waivers of class actions, barring mandatory pre-dispute arbitration agreements, and requiring the institution to provide to the Department copies of initial filings and subsequent filings, awards, and decisions in borrower defense suits or arbitrations, to be valuable independently and to operate independently and to serve separate but complementary objectives. Accordingly, in an abundance of caution, we propose in §685.309 to specify the Department's intent that if any provision of subpart C of part 685 is held invalid, the remaining parts shall not be affected.

Executive Orders 12866 and 13563

Regulatory Impact Analysis

Introduction

Under Executive Order 12866, it must be determined 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.

This proposed regulatory action would have an annual effect on the economy of more than $100 million because the proposed regulations would have annual federal budget impacts of approximately $199 million in the low impact scenario to $4.2323 billion in the high impact scenario at 3 percent discounting and $198 million and $4.17 billion at

7 percent discounting, additional transfers from affected institutions to student borrowers via reimbursements to the Federal government, and annual quantified costs of $14.9 million related to paperwork burden. Therefore, this proposed action is "economically significant" and subject to review by OMB under section 3(f) of Executive Order 12866. Notwithstanding this determination, we have assessed the potential costs and benefits, both quantitative and qualitative, of this proposed regulatory action and have determined that the benefits would justify the costs.

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."

We are issuing these proposed regulations only on a reasoned determination that their benefits would justify their costs. In choosing among alternative regulatory approaches, we selected those approaches that maximize net benefits. Based on the analysis that follows, the Department believes that these proposed regulations are consistent with the principles in Executive Order 13563.

We also have determined that this regulatory action would not unduly interfere with State, local, and tribal governments in the exercise of their governmental functions.

In this regulatory impact analysis we discuss the need for regulatory action, the potential costs and benefits, net budget impacts, assumptions, limitations, and data sources, as well as regulatory alternatives we considered.

Under "Initial Regulatory Flexibility Act Analysis," we consider the effect of the proposed regulations on small entities.

Need for Regulatory Action

The proposed regulations address several topics related to the administration of title IV, HEA student aid programs and benefits and options for borrowers. As stated in the preamble, the Department first implemented borrower defense regulations for the Direct Loan Program in the

1995-1996 academic year to protect borrowers. The Department's original intent was for this rule to be in place for the 1995-1996 academic year, and then to develop a more extensive rule for both the Direct and FFEL loan programs through negotiated rulemaking in the following year.

However, based on the recommendation of non-Federal negotiators in the spring of 1995, the Secretary decided not to develop further regulations for the Direct Loan and FFEL programs. As a result, the regulations have not been updated in two decades to establish appropriate processes or provide other necessary information to allow borrowers to effectively utilize borrower defenses.

For instance, the current regulations require an analysis of State law in order to determine the validity of a borrower defense claim. This approach creates complexities in determining which State law applies and potential inequities, as students in one State may receive different relief than students in another State, despite having common facts and claims.

For example, the landscape of higher education has changed significantly over the past 20 years. In particular, the role of distance education in the higher education sector has grown substantially. In the 1999-2000 academic year, about eight percent of students were enrolled in at least one distance education course; by the 2007-2008 academic year, that number had grown to 20 percent.[70] Recent IPEDS data indicate that in the fall of 2013, 26.4 percent of students at degree-granting, title IV participating institutions were enrolled in at least one distance education class.[71] Much of this growth occurred within, and coincided with, the growth of the proprietary higher education sector. In the fall of 1995, degree-granting, for-profit institutions enrolled approximately 240,000 students. In the fall of 2014, degree-granting, for-profit schools enrolled over 1.5 million students.[72] These changes to the higher education industry have allowed students to enroll in colleges based in other States and jurisdictions with relative ease.

These changes have also had an impact on the Department's ability to apply its borrower defense

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[70] Learning at a Distance: Undergraduate Enrollment in Distance Education Courses and Degree Programs (http://nces.ed.gov/pubs2012/2012154.pdf).

[71] 2014 Digest of Education Statistics: Table 311.15: Number and percentage of students enrolled in degree-granting postsecondary institutions, by distance education participation, location of student, level of enrollment, and control and level of institution: fall 2012 and fall 2013.

[72] 2015 Digest of Education Statistics: Table 303.10: Total fall enrollment in degree-granting postsecondary institutions, by attendance status, sex of student, and control of institution: Selected years, 1947 through 2025 (http://nces.ed.gov/programs/digest/d14/tables/dt14_303.10.asp?current=yes}.

regulations. The current borrower defense regulations do not identify which State's law is considered the "applicable" State law on which the borrower's claim can be based.[73] Generally, the regulation was assumed to refer to the laws of the State in which the institution was located; we did not have much occasion to address differences in protection for borrowers in States that offer little protection from school misconduct or borrowers who reside in one State but are enrolled via distance education in a program based in another State. Some States have extended their rules to protect these students, while others have not.

As noted in the preamble, Corinthian, a publicly traded for-profit higher education company that enrolled over 70,000 students at more than 100 campuses nationwide, filed for bankruptcy in 2015 after being the subject of multiple investigations and actions by Federal and State governments. While the Department is committed to ensuring that students harmed by Corinthian's misrepresentations receive the relief to which they are entitled under the current borrower defense and closed school discharge regulations, the Department also recognized that the

[73] In the few instances prior to 2015 in which claims have been recognized under current regulations, borrowers and the school were typically located in the same State.

existing rules made this process burdensome, both for borrowers and for the Department. As the Department began to determine the best process for dealing with the fall-out of the Corinthian bankruptcy, it became apparent that under the current process, significant Department resources would be required to review individual State laws to determine the law that would be applicable to claims that might be received from many of these individual borrowers. In order to create and oversee a process to provide debt relief for these Corinthian students who applied for Federal student loan discharges based on claims against Corinthian, the Department appointed a Special Master in June of 2015.

As a result of this experience, the Department is proposing new regulations that would develop a Federal standard for borrower defense to help ensure that all Direct Loan borrowers have a process to obtain adequate loan relief for injury caused by the acts or omissions of the institutions they attended. The proposed regulations would also provide clarity to the process by which a borrower defense is asserted and resolved. To protect taxpayers and the Federal government, the Department also seeks to hold institutions responsible for their acts and omissions that give rise to borrower defenses. The proposed regulations would also limit required arbitration or internal institutional dispute resolution processes for borrower defense claims.

Additionally, to enhance and clarify other existing protections for students, the proposed regulations would update the basis for obtaining a false certification discharge, clarify the processes for false certification and closed school discharges, require institutions to provide applications and explain the benefits and consequences of a closed school discharge, and establish a process for a closed school discharge without an application for students who do not re-enroll in a title IV-participating institution within three years of an institution's closure. The proposed regulations would also codify the Department's practice that a discharge based on school closure, false certification, unpaid refund, or defense to repayment will result in the elimination or recalculation of the subsidized usage period associated with the loan discharged.

The Department also proposes to amend the regulations governing the consolidation of Nursing Student Loans and Nurse Faculty Loans so that they align with the statutory requirements of section 428C(a)(4)(E) of the HEA; clarify rules regulating the capitalization of interest on defaulted FFEL Loans; require that proprietary schools with zero or negative loan repayment rates warn prospective and enrolled students of those repayment rate outcomes; require that a school disclose on its Web site and to prospective and enrolled students if it is required to provide financial protection to the Department; clarify the treatment of spousal income in the PAYE and REPAYE plans; and make other changes that we do not expect to have a significant economic impact.

We believe that our proposals in this NPRM represent our best efforts to engage all sectors of the postsecondary industry and develop regulations that are both effective and practical.

Summary of Proposed Regulations

The table below briefly summarizes the major provisions of the proposed regulations.

Table 2: Summary of Proposed Regulations

Provision	**Reg Section**	**Description of Provision**
Borrower Defense to Repayment		
Applicability	§685.206	Clarifies that existing regulations apply to loans first disbursed before July 1, 2017.
State Law	§685.206	Clarifies that a borrower defense claim may be asserted if an institution violates applicable State law as it

		relates to the making of the loan or the provision of educational services.
Federal Standard and Process	§685.222	Adds a new section addressing borrower defenses for loans first disbursed on or after July 1, 2017, and defines circumstances under which a borrower defense may be established. Establishes a process for asserting and determining a borrower defense claim for loans first disbursed before and after July 1, 2017.
Misrepresentation	§668.71 §685.222 (d)(2)	Amends the definition of "misrepresentation" for what the Secretary may consider in determining whether schools engaged in misrepresentation for §668.71, adopts the definition for §685.222, and in §685.222 requires that a borrower must have reasonably relied on the misrepresentation.
Remedial Action and Recovery from the Institution	§685.206 §685.222 (e)	Removes provision that the Secretary will not initiate action to recover after the end of the three-year record retention period. Establishes that the Secretary may initiate an action to recover for the amount of relief resulting from an individually filed and determined borrower defense application.

	§685.222 (h)(5) §685.308	Indicates that the Secretary will recover the amount of relief resulting from a group process for borrower defenses with respect to loans made to attend an open school. Revises to describe grounds on which an institution causes a loss for which the Secretary holds schools accountable, along with the procedures to establish and enforce that liability.
Administrative Forbearance	§685.205 (b)(6) §682.211	Adds a mandatory administrative forbearance during the period when the Secretary is determining the borrower's eligibility for a borrower defense discharge. Mirrors the Direct Loan mandatory administrative forbearance for FFEL program loans.
Limits on Dispute Resolution Procedures	§685.300 (b)(11), (d)-(i)	Adds to Direct Loan program participation agreement provisions relating to schools' use of certain dispute resolution procedures. Under these proposed provisions, schools may not: (1) require students to pursue borrower defense complaints through an internal institutional process before the student presents the complaint to an accrediting agency or government agency; (2)

		require arbitration of a potential borrower defense claim asserted through a class action lawsuit until a court has denied class certification or dismissed the class claim, and, if that ruling may be subject to appellate review on an interlocutory basis, the time to seek such review has elapsed or the review has been resolved, or (3) compel a student to enter into a pre-dispute agreement to arbitrate a borrower defense claim, or to rely in any way on a pre-dispute arbitration agreement with respect to any aspect of a borrower defense claim. Requires institutions to include the notices and provisions in §685.300(e)(3) in any agreements entered into after effective date of this regulation with a student recipient of a Direct Loan for attendance at the school, or, with respect to a Parent PLUS Loan, a student for whom the PLUS loan was obtained, including any agreement regarding arbitration. Requires institutions to notify the Secretary of the initial filing of the claim, whether in court or in arbitration, and provide

		copies of the complaint and any counterclaim, any pre-dispute arbitration agreement filed with the arbitrator or arbitration administrator, any dispositive motion filed by a party to the suit, and the ruling on any dispositive motion and the judgment issued by the court. For agreements executed before the effective date of the proposed regulation, requires institutions to comply with the regulations and either amend the agreements or notify students that the institution would not attempt to exercise those agreements in a manner proscribed by the proposed regulations. Notification would occur no later than exit counseling, or in the case of previously enrolled students who did not receive the updated exit counseling and who sue or file for arbitration, the date on which the institution files its initial response or answer to a complaint in a lawsuit or demand for arbitration made by a student who was not already provided with notice or amendment.
Closed School Discharge		
Provide	§668.14(	Requires a school to provide to all enrolled students,

Application	b)(32)	after the Department initiates any action to terminate the school's participation, a closed school discharge application and a written disclosure of the benefits and consequences of a closed school discharge as an alternative to a teach-out.
Departmental Review of Guaranty Agency Denials	§682.402 (d)(6)(ii)(F)	Requires guaranty agency that denies a closed school discharge request to inform borrower of opportunity for review by the Secretary.
Discharge without Application	§674.33(g)(3)(iii); §682.402 (d)(8)(iii); §685.214 (c)(2)	Authorizes the Department or a guaranty agency acting with the Department's permission to grant a closed school discharge without borrower application based on evidence in the Department's or guaranty agency's possession that the borrower did not subsequently re-enroll in a title IV institution within three years after the school closed.
False Certification Discharge		
Basis for Discharge	§685.215	Eliminates references to "ability-to-benefit" and establishes as grounds for a false certification discharge the certification of eligibility of a student who is not a high school graduate or the improper certification of a borrower's satisfactory

		academic progress. Borrower can also qualify for false certification discharge if the borrower failed to meet applicable State requirements for employment due to physical or mental condition, age, criminal record, or other reason accepted by the Secretary that would prevent the borrower from obtaining employment in the field for which the training program supported by the loan was intended.
Process	§685.215 (d)	Updates procedures and describes evidence the Department uses to determine eligibility for a false certification discharge. Also requires the Department to: explain to the borrower the reasons for a denial and the evidence the determination was based on; provide the borrower with an opportunity to submit additional evidence; and notify the borrower if the determination changes based on the additional evidence submitted.
Other Provisions		
Disclosures and Warnings	§668.41(h) and (i)	Requires warning to enrolled and prospective students by a proprietary institution that does not qualify for a low

		borrowing exemption if its loan repayment rate is equal to or below zero percent. Requires disclosure by an institution from any sector that is required to provide financial protection to the Secretary such as an irrevocable letter of credit or cash under §668.175(d) or (f), or to establish a set-aside under §668.175(h). Specifies manner in which such disclosures must be made.
Interest Capitalization	§682.202 (b)(1); §682.410 (b)(4); §682.405	Clarifies that interest capitalization when a guaranty agency sells a rehabilitated loan is not permitted. Also clarifies 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, capitalization is not permitted if collection on the loan resumes because the borrower does not return the appropriate form within the allotted timeframe.
150 Percent Direct Subsidized Loan Limit	§682.202	Codifies Department's current practice that a discharge based on school closure, false certification, unpaid refund, or defense to repayment will lead to the

		elimination (for full discharge) or recalculation (for partial discharge) of the subsidized usage period that is associated with the loan or loan discharged. If the discharge results in a remaining eligibility period greater than zero, the borrower is no longer responsible for interest that accrues on a Direct Subsidized Loan or portion of a Direct Consolidation Loan that repaid a Direct Subsidized Loan, unless the borrower again exceeds the 150 percent limit with additional borrowing.
Electronic Death Certificate	§674.61(a); §682.402(b)(2); §685.212(a); §686.42(a)	Allows death discharges to be based on an accurate and complete original or certified copy of the death certificate that is scanned and submitted electronically or through verification of the death through an authoritative Federal or State electronic database approved by the Secretary.
Debt Compromise Authority	34 CFR 30.70	Reflects increased debt compromise authority to $100,000. Clarifies that generally applicable limit does not apply to claims arising under FFEL, Direct Loans, or Perkins Loan programs and requires that the Department

		seek DOJ review for resolution of such claims over $1,000,000.
PAYE and REPAYE Clarifications	§685.209 (a) and (c)	For REPAYE, removes language regarding, and cross-references to, partial financial hardship. For REPAYE, makes it clear that no adjustment is made to a borrower's monthly payment for a spouse's eligible loan debt if the spouse's income is excluded from the calculation of the borrower's monthly payment. For PAYE and REPAYE, makes it clear that the inclusion of FFEL Loans in the definition of "eligible loans" is to take them into consideration for certain terms and conditions of the PAYE and REPAYE plans, but does not allow FFEL program loans to be repaid under these plans.
Nurse Faculty Loan, Federal Perkins, or Health Professions Student Loan Consolidation	§685.220	Provides that nurse faculty loans made under part E of title VIII of the Public Health Service Act may be consolidated into a Direct Consolidation Loan. Reflects updates to statutory language. Revises §685.220(d)(1)(i) to allow a borrower to obtain a Direct Consolidation Loan if the borrower consolidates at least one eligible loan under

		§685.222(b). This reflects the Department's long-standing policy that generally Direct Program Loans should be given the same treatment for parallel aspects of FFEL Loans, unless otherwise provided for in the HEA or the Department's regulations.

Discussion of Costs and Benefits

The primary potential benefits of the proposed regulations are: (1) an updated and clarified process and a Federal standard to improve the borrower defense process and usage of the borrower defense process and to increase protections for students; (2) increased financial protections for taxpayers and the Federal government; (3) additional information to help students, prospective students, and their families make educated decisions based on information about an institution's financial soundness and its borrowers' loan repayment outcomes; (4) improved conduct of schools by holding individual institutions accountable and thereby deterring misconduct by other schools; (5) improved awareness and usage, where appropriate, of closed school and false certification discharges; and (6) technical changes to improve the administration of the title IV, HEA programs.

We have considered and determined the primary costs and benefits of the proposed regulations for the following groups or entities that we expect to be impacted by the proposed regulations:

- Students and borrowers
- Institutions
- Guaranty agencies and loan servicers
- Federal, State, and local government

Borrower Defense, Closed School Discharges, and False Certification Discharges

Students and Borrowers

Borrowers would be the primary beneficiary of the proposed regulations. The proposed regulations would allow borrowers to navigate the borrower defense process more efficiently and effectively. A simplified process may encourage borrowers who may have been unaware of the process, or intimidated by the complexity of the process in the past, to file a claim.

Furthermore, these proposed changes could reduce the number of borrowers who are struggling to meet their student loan obligations. During the public comment periods of the negotiated rulemaking sessions, many public commenters who were borrowers mentioned that they felt that they had been defrauded by their institutions of higher education and were unable to pay their student loans or obtain debt relief under the current regulations. Future borrowers are less likely to face these misrepresentations, since the financial consequences to schools would be dire.

Providing an automatic forbearance with an option for the borrower to decline the temporary relief and continue making payments would reduce the potential burden on borrowers pursuing borrower defenses. These borrowers would be able to focus on supplying the information needed to process their borrower defense claims without the pressure of continuing to make payments on loans for which they are currently seeking relief. When claims are successful, there will be a transfer between the Federal government and affected student borrowers as balances are forgiven and some past payments are returned. In the scenarios described in the Net Budget Impacts section of this analysis, those transfers range from $182 million to $5.8 billion annually.

Borrowers who ultimately have their loans discharged will be relieved of debts they may not have been able to repay, and that debt relief can ultimately allow them to become bigger participants in the economy, possibly buying a home, saving for retirement, or paying for daycare. They also will be able to return into the higher education marketplace and pursue credentials they need for career advancement. To the extent borrowers have subsidized loans, the elimination or recalculation of the borrowers' subsidized usage period could relieve them of their responsibility for accrued interest and make them eligible for additional subsidized loans, which could make returning to higher education a more acceptable option.

The proposed regulations would also give borrowers more information with which they can make informed decisions about the institutions they choose to attend. An institution would be required to disclose the reasons that it was required to obtain a letter of credit. Recent events involving closure of several large proprietary institutions have shown the need for lawmakers, regulatory bodies, State authorizers, taxpayers, and students to be more broadly aware of circumstances that could affect the continued existence of an institution. The disclosure of institutions' status as being required to provide financial protection would allow borrowers to receive early warning signs that an institution's financial or accreditation status may be at risk, and therefore borrowers may be able to withdraw or transfer to an institution in better standing in lieu of continuing to work towards earning credentials that may have limited value.

Proprietary institutions would also be required to provide a warning to prospective and enrolled students if their repayment rate is equal to or below zero percent. To estimate the effect of the repayment rate warning on institutions, the Department analyzed College Scorecard data and found that 493 of 1,174 proprietary institutions with repayment rates in the data had rates less than or equal to 50 percent, roughly equivalent to a repayment rate of zero percent or below, which would trigger the warning requirement under the proposed regulations. This analysis does not take into account the low borrowing exemption, and does not include graduate students.

Institutions

Institutions would bear many of the costs of the proposed regulations, which fall into three categories: paperwork costs associated with compliance with the regulations; other compliance costs that may be incurred as institutions adapt their business practices and training to ensure compliance with the regulations; and costs associated with obtaining letters of credit or suitable equivalents if required by the institution's performance under a variety of triggers. Additionally, there may be a potentially significant amount of funds transferred between institutions and the Federal government as reimbursement for successful claims. Some institutions may close some or all of their programs if their activities generate large numbers of borrower defense claims.

A key consideration in evaluating the effect on institutions is the distribution of the impact. While all institutions participating in title IV loan programs are subject to the possibility of borrower defense, closed school, and false certification claims and the reporting requirements in the proposed regulations, the Department expects that fewer institutions will engage in conduct that generates borrower defense claims. Eventually, the proposed regulations can be expected to reduce the number of schools that would face the most significant costs to come into compliance, transfers to reimburse the government for successful claims, costs to obtain required letters of credit, and disclosure of borrower defense claims against the schools. In the scenarios described in the Net Budget Impacts section of this analysis, the annual transfers from institutions to students, via the Federal government, as reimbursement for successful claims ranges from $55 million to $3.8 billion. On the other hand, it is possible that high-quality, compliant institutions, especially in the for-profit sector, will see benefits if the overall reputation of the sector improves as a result of (1) more trust that enforcement against bad actors will be effective, and (2) the removal of bad schools from the higher education marketplace, freeing up market share for the remaining schools.

The accountability framework in the proposed regulations requiring institutions to provide financial protection in response to various triggers would generate costs for institutions. Some of the triggering provisions would affect institutions differently depending upon their type and control, as, for example, only publicly traded institutions are subject to delisting or SEC suspension of trading, only proprietary institutions are subject to the 90/10 rule, and public institutions are not subject to the financial protection requirements. To the extent data were available, the Department evaluated the financial protection triggers to analyze the expected impact on institutions. Several of the triggers are based on existing performance measures and are aimed at identifying institutions that may face sanctions and experience difficulty meeting their financial obligations. The triggers and their potential consequences are discussed in Table 3.

Table 3: Automatic Triggers

Trigger	**Description**	**Impact**
Automatic Triggers (institution found to be not financially responsible under §668.171 and must qualify under an alternative standard)		
State or Federal agency actions	If currently or in three most recently completed award years an institution has to repay a debt or liability arising from an investigation by a State, Federal, or other oversight entity, or settles or resolves a suit brought by one of those entities related to the making of a Federal loan or the provision of educational services, or has been sued by a government agency for such claims, unless that suit has since been dismissed. Material if amount exceeds the audit threshold in 2 CFR part 200, currently $750,000, or 10 percent of current assets. For judgments entered against the institution in most	Since 2010, at least 25 institutions have been investigated or reached settlements with State AGs, with some being involved in actions by multiple States. Federal agencies, including the Department, DOJ, FTC, CFPB, and the SEC have been involved in actions against at least 20 institutions, with multiple actions against some schools. Amount of financial protection calculated as 10 percent or more, as determined by the Secretary, of the amount of Direct Loans received by the institution in the most recently completed fiscal year.

	recent fiscal year in suit by government agency, if amount exceeds thresholds above. For suits by State, Federal, or other oversight entities unrelated to Federal loans or provision of educational services, if the potential damages exceed 10 percent of current assets. For pending qui tam suits or suits by private parties related to borrower defense-type claims if the suit has survived a motion for summary judgment and the suit seeks recovery of 10 percent of current assets or more.	
Repayments to the Secretary	Currently or at any time in the three most recently completed award years, the institution was required to repay the Secretary for any losses from borrower defense claims that exceeded the lesser of the audit threshold amount in 2 CFR part 200 (currently	Amount of required financial protection calculated as the greatest annual loss incurred in the last three completed award years plus the portion of outstanding claims represented by the ratio of successful borrower claims to total claims over the three most recently

	$750,000) or 10 percent of current assets.	completed award years.
Accrediting Agency Actions	If currently or at any time in the three most recently completed award years, the institution’s primary accrediting agency required the institution to submit a teach-out plan for itself or any additional branches or locations or placed the institution on probation, issued a show-cause order, or placed the institution in a similar accreditation status for failing to meet one or more of the agency’s standards, and the accrediting agency does not notify the Secretary within six months that the institution has come into compliance.	In the past three fiscal years, 52 non-public institutions have lost eligibility based on accreditation issues and 54 were put on heightened cash monitoring level two.
Loan Agreements and Obligations	If an institution discloses in a note in its most recently audited financial statement that it violated a provision or requirement in a loan agreement with its largest secured creditor or failed to	

	make a payment for more than 120 days to its largest secured creditor. Also, the occurrence of a monetary or nonmonetary default or delinquency event, as defined under the terms of a security or loan agreement between the institution and the creditor with the largest secured extension of credit to the institution, or the occurrence of any other event as provided under such an agreement that triggers or provides a recourse by the creditor for an increase in collateral, changes in contractual obligations, an increase in interest rates or payments, or imposes some sanction, penalty, or fee upon the institution.	
Non-Title IV Revenue	If the institution fails the 90/10 revenue test in the most recently completed fiscal year. Applies to proprietary institutions only.	In the most recent 90/10 report, 14 institutions received 90 percent or more of their revenues from title IV funds. The total title IV funding for those institutions

		in award year (AY) 2013-14 was $57 million.
Publicly Traded Institutions	If the institution's stock is involuntarily delisted from the exchange on which it is traded, the SEC warns the institution it will suspend trading on the institution's stock, or the institution fails to file a required annual or quarterly report with the SEC on time, or the institution disclosed or was required to disclose in a report filed with the SEC a judicial or administrative proceeding not covered under the triggers listed above.	
Gainful Employment	For institutions where over 50 percent of students who receive title IV aid are enrolled in GE programs, if more than 50 percent of those enrolled in GE programs are in programs that failed or are in the zone under the D/E rates measure.	The Department found that of 3,958 institutions that reported GE programs for 2013-14, 1,059 institutions had a D/E rate in our 2011 GE Informational Rates and over 50 percent of their enrollment in GE programs. Of these, 107 non-public institutions had more than 50 percent of

		their GE enrollment in zone or failing programs. Title IV aid received by these institutions in AY2014-15 totaled $1.02 billion. The Department will continue to monitor this trigger as more recent D/E rates become available.
Withdrawal of Owner's Equity	For institutions with a composite score under 1.5, any withdrawal of owner's equity from the institution by any means, including by declaring a dividend.	
Cohort Default Rates	Institution's two most recent cohort default rates are 30 percent or greater. Does not apply if institution files a challenge, request for adjustment, or appeal with respect to its CDR, and that action results in reducing the CDR below 30 percent or the institution not losing eligibility or not being placed on provisional certification.	From the most recently released official CDR rates, for AY2012-13 and AY2011-12, 37 of 3,081 non-public institutions that had CDR rates in both years were over 30 percent in both years. Title IV aid received by these institutions in AY2014-15 totaled $27.8 million.

Discretionary Triggers		
Significant Fluctuation in Direct Loan or Pell Grant Volumes	There are significant fluctuations in Direct Loan or Pell Grant funds, or a combination of those funds, received by the institution in consecutive award years that cannot be explained by changes in the institutions' programs. No specific threshold is established.	The Department looked at fluctuations in Direct Loan amounts and found that 991 of 3,590 non-public institutions had an absolute change in Direct Loan volume of 25 percent or more between the 2013-14 and 2014-15 award years.
High Annual Dropout Rates	High dropout rates as calculated by the Secretary. No specific threshold is established.	The Department analyzed College Scorecard data to develop a withdrawal rate within six years. Of 928 proprietary institutions with data, 482 had rates from 0 to 20 percent, 415 from 20 to 40 percent, 30 from 40 to 60 percent, and 1 from 60 to 80 percent. Of 1,058 private not-for-profit institutions with data, 679 had rates from 0 to 20 per cent, 328 from 20 to 40 percent, 51 from 40 to 60 percent, and none above 60 percent. Of 1,476 public institutions with data, 857 had rates from 0 to 20 per cent,

		587 from 20 to 40 percent, 32 from 40 to 60 percent, and none above 60 percent.
State Licensing Agency	Institution is cited by State licensing or authorizing agency for failing State or agency requirements.	
Financial Stress Test	The institution fails a financial stress test used to evaluate whether the institution has sufficient resources to absorb losses that may be incurred as a result of adverse conditions and continue to meet its obligations to students and to the Secretary.	
Credit Rating	Institution or corporate parent has non-investment grade bond or credit rating.	According to Moody's Investors Services, it rates over 500 universities representing the majority of debt in the sector. This includes over 230 four-year public institutions, which are exempt from the financial protection triggers, and almost 275 private colleges and universities. Of these, only 12 were

		below the Baa3 rating for investment grade as of December 2014, but the report did note that downgrades were more common than upgrades.[74]
SEC 8-K Reporting	If an institution reports an adverse event to the SEC on a Form 8-K	At least eight publicly traded institutions have reported events in Form 8-K filings, with most reporting multiple events in the past five years.

In addition to any resources institutions would devote to training or changes in business practices to improve compliance with the proposed regulations, institutions would incur costs associated with the reporting and disclosure requirements of the proposed regulations. This additional workload is discussed in more detail under Paperwork Reduction Act of 1995. In total, the proposed regulations are estimated to increase burden on institutions participating in the title IV, HEA programs by

[74] See Moody's Investors Service, *The Financial & Strategic Outlook for Private Colleges*, January 5, 2015, available at www.cic.edu/News-and-Publications/Multimedia-Library/CICConferencePresentations/2015%20Presidents%20Institute/20150105-The%20Financial%20and%20Strategic%20Outlook%20for%20Private%20Colleges%205.pdf.

384,293 hours. The monetized cost of this burden on institutions, using wage data developed using BLS data available at www.bls.gov/ncs/ect/sp/ecsuphst.pdf, is $14,045,915. This cost was based on an hourly rate of $36.55.

Guaranty Agencies and Loan Servicers

Several provisions may impose a cost on guaranty agencies or lenders, particularly the limits on interest capitalization. Loan servicers may have to update their process to accept electronic death certificates, but increased use of electronic documents should be more efficient over the long term. As indicated in the Paperwork Reduction Act of 1995 section of this preamble, the proposed regulations are estimated to increase burden on guaranty agencies and loan servicers by 7,622 hours related to the mandatory forbearance for FFEL borrowers considering consolidation for a borrower defense claim and reviews of denied closed school claims. The monetized cost of this burden on guaranty agencies and loan servicers, using wage data developed using BLS data available at www.bls.gov/ncs/ect/sp/ecsuphst.pdf, is $278,584. This cost was based on an hourly rate of $36.55.

Federal, State, and Local Governments

In addition to the costs detailed in the Net Budget Impacts section of this analysis, the proposed regulations would affect the Federal government's administration of the title IV, HEA programs. The borrower defense process in the proposed regulations would provide a framework for handling claims in the event of significant institutional wrongdoing. The Department may incur some administrative costs or shifting of resources from other activities if the number of applications increases significantly and a large number of claims require hearings. Additionally, to the extent borrower defense claims are not reimbursed by institutions, Federal government resources that could have been used for other purposes will be transferred to affected borrowers. Taxpayers will bear the burden of these unreimbursed claims. In the scenarios presented in the Net Budget Impacts section of this analysis, annualized unreimbursed claims range from $64 million to $4.1 billion.

The accountability framework and financial protection triggers would provide some protection for taxpayers as well as potential direction for the Department and other Federal and State investigatory agencies to focus their enforcement efforts. The financial protection triggers may potentially assist the Department as it seeks to identify, and take action regarding, material actions and events that are likely to have an adverse impact on the financial condition or operations of an institution. In addition to the current process where, for the most part, the Department determines annually whether an institution is financially responsible based on its audited financial statements, under these proposed regulations the Department may determine at the time a material action or event occurs that the institution is not financially responsible.

Other Provisions

The technical corrections and additional changes in the proposed regulations should benefit student borrowers and the Federal government's administration of the title IV, HEA programs. Updates to the acceptable forms of certification for a death discharge would be more convenient for borrowers' families or estates and the Department. The provision for consolidation of Nurse Faculty Loans reflects current practice and gives those borrowers a way to combine the servicing of all their loans. Many of these technical corrections and changes involve relationships between the student borrowers and the Federal government, such as the clarification in the REPAYE treatment of spousal income and debt, and they are not expected to significantly impact institutions.

Net Budget Impacts

The proposed regulations are estimated to have a net budget impact in costs over the 2017-2026 loan cohorts ranging between $1.997 billion in the lowest impact scenario to $42.698 billion in the highest impact scenario. 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 provisions most responsible for the costs of the proposed regulations are those related to the discharge of borrowers' loans, especially the changes to borrower defense and closed school discharges. When an institution engages in behavior that could result in successful borrower defense claims against it, there are several possible methods borrowers could pursue to obtain relief under the proposed regulations. If the level of misconduct and resulting investigations and demands for financial protection lead to the closure of the institution, borrowers that fall within the applicable timeframes may choose a closed school discharge. If applicable, borrowers could also consider a false certification discharge based on the institution falsely certifying the borrower's high school diploma or satisfactory academic progress. The cost of these two options is discussed in the Closed School and False Certification Discharges discussion of this Net Budget Impacts section. If the institution does not close, the borrower cannot or does not pursue closed school or false certification discharges, or the Secretary determines the borrower's claim is better suited to a borrower defense group process, the borrower may pursue a borrower defense claim.

Borrower Defense Discharges

The proposed regulations would establish a Federal standard for borrower defense claims related to loans first disbursed on or after July 1, 2017, as well as describe the process for the assertion and resolution of all borrower defense claims--both those made for Direct Loans first disbursed prior to July 1, 2017, and for those made under the proposed regulations after that date. As indicated in this preamble, while regulations governing borrower defense claims have existed since 1995, those regulations have rarely been used. Therefore, the Department has used the limited data it has available on borrower defense claims, especially information about the results of the collapse of Corinthian, projected loan volumes, Departmental expertise, the discussions at negotiated rulemaking, and information about past investigations into the type of institutional acts or omissions that would give rise to borrower defense claims to develop scenarios that the Department believes will capture the range of net budget impacts associated with the borrower defense proposed regulations. The Department will continue to refine these estimates, welcomes comments about the assumptions used in developing them, and will consider those comments as the final regulations are developed.

While there are many factors and details that will determine the cost of the proposed regulations, ultimately a borrower defense claim entered into the student loan model (SLM) by risk group, loan type, and cohort will result in a reduced stream of cash flows compared to what the Department would have expected from a particular cohort, risk group, and loan type. The net present value of the difference in those cash flow streams generates the expected cost of the proposed regulations. In order to generate an expected level of claims for processing in the SLM, the Department used President's Budget 2017 (PB2017) loan volume estimates to identify the maximum potential exposure to borrower defense claims for each cohort, loan type, and sector. While all of the PB2017 projected Direct Loan volume for the 2017 to 2026 cohorts of over $1 trillion is subject to the proposed regulations, the Department expects only a fraction of that amount to be affected by institutional behavior that results in a borrower defense claim (labeled as "Misrep Scenario" in Table 4). Additionally, while FFEL, Perkins, and certain other Federal student loan borrowers are able to claim relief under the Direct Loan process by consolidating into a Direct Loan, borrowers may choose not to consolidate because they may lose some benefits in doing so or because they have determined that their chances of success under the borrower defense process may not warrant the step of consolidation. As a result, the percentage of that volume that consolidates will also affect the estimated net budget impact. The budget impact would be further affected by the percentage of potentially eligible borrowers who successfully pursue a claim (labeled as "Borr Claim Pct" in Table 4) and the level of recoveries the Department is able to receive from institutions subject to borrower defense claims (labeled as "Recovery Pct" in Table 4). The scenarios presented in this budget estimate involve assumptions about these factors as shown in Table 4. The Department also faced a challenge in establishing the appropriate baseline against which to compare the costs of the regulation. Due to the limited history of borrower defense claims, existing budget estimates contain no data from which to devise a baseline. While many borrowers who will pursue a claim through the new process would have been able to do so under the existing standard, the Department is attributing their claims to the proposed regulations. That is, while the costs we are describing here are the actual projected costs of borrower defense discharges, not all of them are attributable to the new standard proposed in this regulation. Another factor that could mitigate the costs to the Federal government of the proposed regulations (and change the nature of the costs experienced by affected institutions) is that elimination or modification of the practices giving rise to borrower defense claims could improve outcomes for student borrowers. In the scenarios, we assume that 4-year institutions may be able to implement training or practice changes faster than some smaller 2-year institutions, resulting in a lower upper end of the range for the Misrep Scenario 2. To avoid underestimating the potential cost of the proposed regulations, the Department did not explicitly adjust its estimates for this factor.

Table 4: Assumptions for Budget Scenarios

Sector	Misrep Scenario 1 (% of	Misrep Scenario 2 (%	Borr Claim Pct A	Borr Claim Pct B	Recovery Pct 1 (% of	Recovery Pct 2

	volume)	of volume)	(% of volume)	(% of volume)	claim)	(% of claim)
2yr or less public	0.5%	2%	10%	75%	30%	65%
2yr or less private not-for-profit	0.5%	2%	10%	75%	30%	65%
2yr or less private for profit	5%	25%	10%	75%	30%	65%
4yr public	0.5%	1%	10%	75%	30%	65%
4yr private not-for-profit	0.5%	1%	10%	75%	30%	65%
4yr private for profit	5%	20%	10%	75%	30%	65%

The combined application of these assumptions created the eight (= two Misrep Scenarios × two Borr Claim Pct × two Recovery Pct) scenarios evaluated in the SLM as an increase in the claims rate. Scenario 1A2, the lowest Federal budget impact scenario, assumes that institutional misconduct is not widespread, but instead limited to actors representing a small share of loan volume. It also assumes that the increased information about the availability of borrower defense relief does not lead to a significant increase in the percentage of borrowers making a claim, and that the Department recovers a substantial portion of successful claims from institutions. As shown in Table 4, the other end of the range is represented by Scenario 2B1, in which a high percentage of borrowers from institutions representing a significant percent of loan volume make successful claims and the Department is unable to recover a significant amount from institutions. The Department also estimated the impact if the Department received no recoveries from institutions for each combination of misrepresentation and borrower claim percentage scenario, the results of which are discussed after Table 5.

The Department does not specify how many institutions are represented in each scenario, as the scenario could represent a substantial number of institutions engaging in acts giving rise to borrower defense claims or could represent a small number of institutions with significant loan volume subject to a large number of claims. According to Federal Student Aid data center loan volume reports,[75] the five largest proprietary institutions in loan volume received 26 percent of Direct Loans disbursed in the

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[7575] Federal Student Aid, *Student Aid Data: Title IV Program Volume by School*, available at https://studentaid.ed.gov/sa/about/data-center/student/title-iv.

proprietary sector in award year 2014-15 and the 50 largest represent 69 percent. The Department has not assigned specific probabilities to any of the scenarios and the results in Table 5 and the likelihood of any one scenario will depend on how institutions conduct their activities to ensure compliance, how much borrowers' awareness of their options increases, and the extent of the deterrent effect that the Department's and other agencies' efforts to uncover and sanction misconduct through investigations and enforcement may have on the industry.

Table 5: Budget Estimates for Borrower Defense Scenarios

Scenario	**Estimated Costs for Cohorts 2017-2026 ($mns)**	**Annualized Cost to Federal Gov't (3% discounting)**	**Annualized Cost to Federal Gov't (7% discounting)**
1A1:	$1,297	$128	$127
1A2:	$646	$64	$63
1B1:	$10,174	$1,007	$993
1B2:	$5,072	$502	$446

2A1:	$5,498	$544	$537
2A2:	$2,752	$272	$269
2B1:	$41,347	$4,092	$4,039
2B2:	$20,674	$2,046	$2,020

The transfers among the Federal government and affected borrowers and institutions associated with each scenario above are included in Table 6, with the difference in amounts transferred to borrowers and received from institutions generating the budget impact in Table 5. In the absence of any recovery from institutions, taxpayers would bear the full cost of successful claims from affected borrowers. At a 3 percent discount rate, the annualized costs with no recovery are approximately $184 million for Misrep_Scenario_1 and Borr Claim_Pct_A, $1.44 billion for Misrep_Scenario_1 and Borr Claim_Pct_B, $778 million for Misrep_Scenario_2 and Borr Claim_Pct_A, and $5.85 billion for Misrep_Scenario_2 and Borr Claim_Pct_B. At a 7 percent discount rate, the annualized costs with no recovery are approximately $180 million for Misrep_Scenario_1 and Borr Claim_Pct_A, $1.42 billion for Misrep_Scenario_1 and Borr Claim_Pct_B, $768 million for Misrep_Scenario_2 and Borr

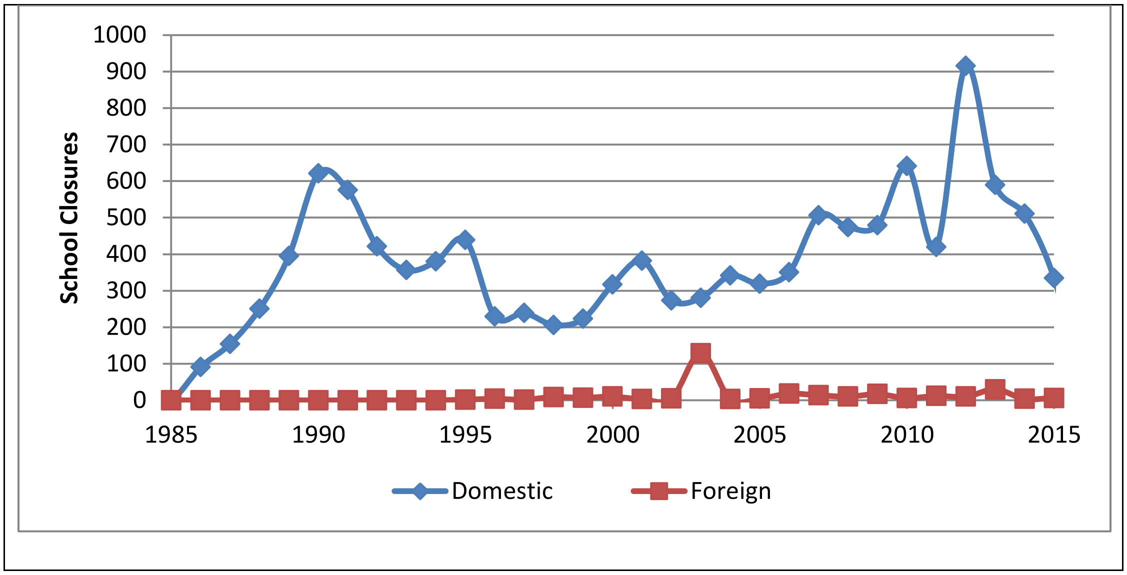
Claim_Pct_A, and $5.77 billion for Misrep_Scenario_2 and Borr Claim_Pct_B. This potential increase in costs demonstrates the significant effect that recoveries from institutions have on the net budget impact of the borrower defense provisions.

Closed School Discharge and False Certification Discharges

In addition to the provisions previously discussed, the proposed regulations also would make changes to the closed school discharge process, which are estimated to cost $1.351 billion for cohorts 2017-2026. The proposed regulations include requirements to inform students of the consequences, benefits, requirements, and procedures of the closed school discharge option, including providing students with an application form, and establishes a Secretary-led discharge process for borrowers who qualify but do not apply and, according to the Department's information, did not subsequently re-enroll in any title IV-eligible institution within three years from the date the school closed. The increased information about and automatic application of the closed school discharge option and possible increase in school closures related to the institutional accountability provisions in the proposed regulations are likely to increase closed school claims.

Chart 1 provides the history of closed schools, which totals 12,040 schools through April 2016.

Chart 1: History of School Closures



In order to estimate the effect of the proposed changes to the discharge process that would grant relief without an application after a three-year period, the Department looked at all Direct Loan borrowers at schools that closed from 2008-2011 to see what percentage of them had not received a closed school discharge and had no record of title-IV aided enrollment in the three years following their school's closure. Of 2,287 borrowers in the file, 47 percent had no record of a discharge or subsequent title IV aid. This does not necessarily mean they did not re-enroll at a title IV institution, so this assumption may overstate the potential effect of the three-year discharge provision.

The Department used this information and the high end of closed school claims in recent years to estimate the effect of the proposed regulations related to closed school discharges. The resulting estimated cost to the Federal government of the closed school provisions is $1.351 billion over the 2017 to 2026 loan cohorts.

The proposed regulations would also change the false certification discharge process to include instances in which schools certified the eligibility of a borrower who is not a high school graduate (and does not meet applicable alternative to high school graduate requirements) where the borrower would qualify for a false certification discharge if the school falsified the borrower's high school graduation status; falsified the borrower's high school diploma; or referred the borrower to a third party to obtain a falsified high school diploma. Under existing regulations, false certification discharges represent a very low share of discharges granted to borrowers. The proposed regulations would replace the explicit reference to ability to benefit requirements in the false certification discharge regulations with a more general reference to requirements for admission without a high school diploma as applicable when the individual was admitted, and specify how an institution's certification of the eligibility of a borrower who is not a high school graduate (and does not meet applicable alternative to high school graduate requirements) could give rise to a false certification discharge claim. However, the Department does not expect an increase in false certification discharge claims to result in a significant budget impact from this change. We believe that schools that comply with the current ability to benefit assessment requirement and that honor the current high school graduation requirements will continue to comply in the manner they now do, and we have no basis to believe that changing the terminology or adding false certification of SAP as an example of a reason the Secretary may grant a false certification discharge without an application will lead to an increase in claims that will result in a significant net budget impact. The Department will continue to evaluate the changes to the false certification discharge regulations and welcomes comments to consider as the final analysis of the proposed regulations is developed.

Other Provisions

In addition to the provisions previously discussed, the proposed regulations would also make a number of technical changes related to the PAYE and REPAYE repayment plans and the consolidation of Nurse Faculty Loans, update the regulations describing the Department's authority to compromise debt, and update the acceptable forms of verification of death for discharge of title IV loans or TEACH Grant obligations. The technical changes to the REPAYE and PAYE plans were already reflected in the Department's budget estimates for those regulations, so no additional budget effects are included here. While 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, 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. Allowing death discharges based on death certificates submitted or verified through additional means is convenient for borrowers, but is not estimated to substantially change the amount of death discharges. The proposed updates to the debt compromise limits reflect statutory changes and the Secretary's existing authority to compromise debt, so we do not estimate a significant change in current practices.

Revising the regulations to expressly permit the consolidation of Nurse Faculty Loans is not expected to have a significant budget impact, as this technical change reflects current practices. According to Department of Health and Human Services budget documents, approximately $26.5 million in grants are available annually for schools to make Nurse Faculty Loans, and borrowers would lose access to generous forgiveness terms if they choose to consolidate those loans. Therefore, we would expect the volume of consolidation to be very small, and do not estimate any significant budget impact from this provision.

Assumptions, Limitations, and Data Sources

In developing these estimates, a wide range of data sources were used, including data from the National Student Loan Data System; operational and financial data from Department systems; and data from a range of surveys conducted by the National Center for Education Statistics such as the 2012 National Postsecondary Student Aid Survey. Data from other sources, such as the U.S. Census Bureau, were also used.

Accounting Statement

As required by OMB Circular A-4 (available at www.whitehouse.gov/sites/default/files/omb/assets/omb/circulars/a004/a-4.pdf), in the following table, we have prepared an accounting statement showing the classification of the expenditures associated with the provisions of these regulations. This table provides our best estimate of the changes in annual monetized costs and transfers as a result of these proposed regulations. Expenditures are classified as transfers from the Federal Government to affected student loan borrowers or from affected institutions to students (via the Federal government), as noted.

Table 6: Accounting Statement: Classification of Estimated Expenditures (in millions) with discount rates of three percent and seven percent

Category	**Benefits**	
Updated and clarified borrower defense process and Federal standard to increase protection for student borrowers and taxpayers	not quantified	
Improved awareness and usage of closed school and false certification discharges	not quantified	
Improved consumer information about institutions' performance and practices	not quantified	
Category	**Costs**	
	3%	**7%**

Costs of obtaining Letters of credit or equivalents		not quantified	
Costs of compliance with paperwork requirements		14.95	14.91
Category		**Transfers**	
		3%	**7%**
Borrower Defense claims from the Federal government to affected borrowers (partially borne by affected institutions, via reimbursements)	SC1A1	184	181
	SC1A2	182	180
	SC1B1	1,438	1,419
	SC1B2	1,434	1,415
	SC2A1	777	767
	SC2A2	778	768
	SC2B1	5,846	5,770
	SC2B2	5,846	5,770
Reimbursements of borrower defense claims from affected institutions to affected student borrowers, via the Federal government	SC1A1	55	54
	SC1A2	119	117
	SC1B1	431	426
	SC1B2	932	920
	SC2A1	233	230
	SC2A2	506	499
	SC2B1	1,754	1,731
	SC2B2	3,800	3,751
Closed school discharges from the Federal government to affected students		135	135

Alternatives Considered

In the interest of promoting good governance and ensuring that these proposed regulations produce the best possible outcome, the Department reviewed and considered various proposals from internal sources as well as from non-Federal negotiators and the public. We summarize below the major proposals that we considered but which we ultimately declined to implement in these proposed regulations.

Areas of significant discussion between the Department and the non-Federal negotiators included the group discharge process for borrower defense claims, the limitation periods, the appropriate procedure for considering borrower defense claims including the role of State AGs, legal assistance organizations, the Department, borrowers, and institutions, and the continued use of or adoption of certain State standards for borrower defense claims and the process of the Department's recovery from schools for any liabilities to the Department for borrower defense claims. The extensive discussion of these issues is summarized in the preamble sections related to each topic. In developing the proposed regulations, the Department considered the budgetary impact, administrative burden, and effectiveness of the options it considered.

Clarity of the Regulations

Executive Order 12866 and the Presidential memorandum "Plain Language in Government Writing" require each agency to write regulations that are easy to understand.

The Secretary invites comments on how to make these proposed regulations easier to understand, including answers to questions such as the following:

- Are the requirements in the proposed regulations clearly stated?
- Do the proposed regulations contain technical terms or other wording that interferes with their clarity?
- Does the format of the proposed regulations (grouping and order of sections, use of headings, paragraphing, etc.) aid or reduce their clarity?
- Would the proposed regulations be easier to understand if we divided them into more (but shorter) sections? (A "section" is preceded by the symbol "§" and a numbered heading; for example, §668.16.)
- Could the description of the proposed regulations in the SUPPLEMENTARY INFORMATION section of this preamble be more helpful in making the proposed regulations easier to understand? If so, how?
- What else could we do to make the proposed regulations easier to understand?

To send any comments that concern how the Department could make these proposed regulations easier to understand, see the instructions in the ADDRESSES section.

<u>Initial Regulatory Flexibility Analysis</u>

Description of the Reasons that Action by the Agency Is Being Considered

The Secretary is proposing to amend the regulations governing the Direct Loan Program to establish a new Federal standard, limitation periods, and a process for determining whether a borrower has a borrower defense based on an act or omission of a school. We also propose to amend the Student Assistance General Provisions regulations to revise the financial responsibility standards and add disclosure requirements for schools. Finally, we propose to amend the discharge provisions in the Perkins Loan, Direct Loan, FFEL Program, and TEACH Grant programs. The proposed changes would provide transparency, clarity, and ease of administration to current and new regulations and protect students, the Federal government, and taxpayers against potential school liabilities resulting from borrower defenses.

The U.S. Small Business Administration Size Standards define "for-profit institutions" as "small businesses" if they are independently owned and operated and not dominant in their field of operation with total annual revenue below $7,000,000. The standards define "non-profit institutions" as "small organizations" if they are independently owned and operated and not dominant in their field of operation, or as “small entities” if they are institutions controlled by governmental entities with populations below 50,000. Under these definitions, an estimated 4,365 institutions of higher education subject to the paperwork compliance provisions of the proposed regulations are small entities. Accordingly, we have prepared this initial regulatory flexibility analysis to present an estimate of the effect of the proposed regulations on small entities. The Department welcomes comments on this analysis and requests additional information to refine it.

Succinct Statement of the Objectives of, and Legal Basis for, the Proposed Regulations

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 in §685.206(c) governing defenses to repayment have been in place since 1995, but 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.” In response to the collapse of Corinthian, the Secretary announced in June of 2015 that the Department would develop new regulations to clarify and streamline the borrower defense process, in a manner that would protect borrowers and allow the Department to hold schools accountable for actions that result in loan discharges.

Description of and, Where Feasible, an Estimate of the Number of Small Entities to which the Regulations Will Apply

These proposed regulations would affect institutions of higher education that participate in the Federal Direct Loan Program and borrowers. Approximately 60 percent of IHEs qualify as small entities, even though the range of revenues at the non-profit institutions varies greatly. Using data from the Integrated Postsecondary Education Data System, the Department estimates that approximately 4,365 IHEs qualify as small entities--1,891 are not-for-profit institutions, 2,196 are for-profit institutions with programs of two years or less, and 278 are for-profit institutions with four-year programs.

Description of the Projected Reporting, Recordkeeping, and Other Compliance Requirements of the Regulations, Including an Estimate of the Classes of Small Entities that Will Be Subject to the Requirement and the Type of Professional Skills Necessary for Preparation of the Report or Record

Table 7 relates the estimated burden of each information collection requirement to the hours and costs estimated in the Paperwork Reduction Act of 1995 section of the preamble. This additional workload is discussed in more detail under the Paperwork Reduction Act of 1995 section of the preamble. Additional workload would normally be expected to result in estimated costs associated with either the hiring of additional employees or opportunity costs related to the reassignment of existing staff from other activities. In total, these changes are estimated to increase burden on small entities participating in the title IV, HEA programs by 171,250 hours. The monetized cost of this additional burden on institutions, using wage data developed using BLS data available at www.bls.gov/ncs/ect/sp/ecsuphst.pdf, is $6,259,193. This cost was based on an hourly rate of $36.55.

Table 7: Paperwork Reduction Act for Small Entities

	Reg Section	OMB Control #	Hours	Cost

Program Participation Agreement - requires school to provide enrolled students a closed school discharge application and written disclosure of the benefits of consequences of the discharge as an alternative to completing their educational program through a teach-out.	668.14	OMB 1845-0022	939	$ 34,308
Reporting and Disclosure of repayment rate outcomes and letters of credit to enrolled and prospective students	668.41	OMB 1845-0004	64,084	$2,342,270
Financial Responsibility - reporting of actions or triggering events in 668.171(c) no later than 10 days after action or event occurs	668.171	OMB 1845-0022	1,617	$ 59,094
Alternative Standards and Requirements - ties amount of letter of credit to action or triggering event in 668.171(c)	668.175	OMB 1845-0022	32,336	$1,181,881

Borrower defense process - provides a framework for the borrower defense process. Institutions could engage in fact-finding, provide evidence related to claims and appeal decisions.	685.222	OMB 1845-NEW	530	$ 19,372
Agreements between an eligible school and the Secretary for participation in the Direct Loan Program - prohibits pre-dispute arbitration agreements for borrower defense claims, specifies required agreement and notification language, and requires schools to provide copies of arbitral and judicial filings to the Secretary.	685.300	OMB 1845-NEW2	71,745	$2,622,268

Identification, to the Extent Practicable, of All Relevant Federal Regulations that May Duplicate, Overlap, or Conflict with the Regulations

The proposed regulations are unlikely to conflict with or duplicate existing Federal regulations.

Alternatives Considered

As described above, the Department participated in negotiated rulemaking when developing the proposed regulations, and considered a number of options for some of the provisions. Issues considered include the group discharge process for borrower defense claims, the limitation periods, the appropriate procedure for considering borrower defense claims including the role of State AGs, the Department, borrowers, and institutions, and the continued use of State standards for borrower defense claims. While no alternatives were aimed specifically at small entities, limiting repayment rate warnings to affected proprietary institutions will reduce the burden on the private not-for-profit institutions that are a significant portion of small entities that would be affected by the proposed regulations.

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 668.14, 668.41, 668.171, 668.175, 682.211, 682.402, 685.222, and 685.300 contain information collection requirements. Under the PRA, the Department has submitted 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.

Discussion

Section §668.14--Program participation agreement.

Requirements:

Proposed §668.14(b)(32) would require, as part of the program participation agreement, a school to provide to all enrolled students a closed school discharge application and a written disclosure, describing the benefits and the consequences of a closed school discharge as an alternative to completing their educational program through a teach-out plan after the Department initiates any action to terminate the participation of the school in any title IV, HEA program or after the occurrence of any of the events specified in §668.14(b)(31) that would require the institution to submit a teach-out plan.

Burden Calculation:

From AY 2011-12 to 2014-15 there were 182 institutions that closed (30 private, 150 proprietary, and 2 public). The number of students who were enrolled at the institutions at the time of the closure was 43,299 (5,322 at the private institutions, 37,959 at the proprietary institutions, and 18 at the public institutions). With these figures as a base, we estimate that there could be 46 schools closing in a given award year (182 institutions divided by 4 = 45.5) with an average 238 students per institution (43,299 divided by 182 = 237.9).

We estimate that an institution will require two hours to prepare and process the required written disclosure with a copy of the closed school discharge application and the necessary mailing list for currently enrolled students. We anticipate that most schools will provide this information electronically to their students, thus decreasing burden and cost.

On average, we estimate that it will take the estimated 8 private institutions that will close a total of 324 hours (1,904 students x .17 (10 minutes)) to prepare and process the required written disclosure with a copy of the closed school discharge application and the necessary mailing list for the estimated 1,904 enrolled students.

On average, we estimate that it will take the estimated 38 proprietary institutions that will close a total of 1,537 hours (9,044 students x .17 (10 minutes)) to prepare and process the required written disclosure with a copy of the closed school discharge application and the necessary mailing list for the estimated 9,044 enrolled students.

For §668.14, the total increase in burden will be 1,861 hours under OMB Control Number 1845-0022.

<u>Section §668.41--Reporting and disclosure of information.</u>

<u>Requirements</u>:

Proposed §668.41(h) would expand the reporting and disclosure requirements under §668.41 to provide that, for any fiscal year in which a proprietary institution's loan repayment rate is equal to or less than zero, the institution must deliver a warning about its repayment outcomes to enrolled and prospective students. Institutions with fewer than 10 borrowers, or that meet the threshold for a low borrowing rate exemption, would not be required to make the disclosure.

The process through which a proprietary institution would be informed of its repayment rate, and provided the opportunity to challenge that rate, is included in proposed §668.41(h)(5). Initially, the Department provides to each institution a list composed of students selected in accordance with the methodology in proposed §668.41(h)(3) and discussed above, as well as the draft repayment rate and the underlying data used to make the calculation. A period of 45 days is allowed for institution to make corrections to the underlying data. The institution has 45 days following the date it receives notification of its draft loan repayment rate to challenge the accuracy of the information used by the Department to calculate the draft rate. After considering any challenges to its draft loan repayment rate, the Department notifies the institution of its final repayment rate.

Under proposed §668.41(i), institutions that are required to provide financial protection, including an irrevocable letter of credit or cash under proposed §668.175(d), or set-aside under proposed §668.175(h), would have to disclose information about that requirement to both enrolled and prospective students until released from the letter of credit, or obligation to provide alternative financial protection, by the Department.

The loan repayment warning under proposed §668.41(h) and the financial protection disclosure under proposed §668.41(i) must be provided to both enrolled (§668.41(h)(7)(ii)) and prospective students (§668.41(h)(7)(iii)) by hand delivery as part of a separate document to the student individually or as part of a group presentation. Alternatively, the warning or disclosure may be sent to the primary email address or other electronic communication method used by the institution for communicating with the student. In all cases, the institution must ensure that the warning or disclosure is the only substantive content in the message unless the Secretary specifies additional, contextual language to be included in the message. Prospective students must be provided with the warning or disclosure before the student enrolls, registers, or enters into a financial obligation with the institution.

Under proposed §668.41(h)(8), all promotional materials made available by or on behalf of an institution to prospective students must prominently include the loan repayment warning. All promotional materials, including printed materials, about an institution must be accurate and current at the time they are published, approved by a State agency or broadcast.

Burden Calculation:

There will be burden on schools to review the list identified in §668.41(h)(5)(i)(A) and to submit challenges to the accuracy of the information used to calculate the draft loan repayment rate, as provided in §668.41(h)(5)(iii). Based on an analysis of College Scorecard repayment rate data for 1,174 proprietary institutions, we estimate that 493 proprietary institutions would not meet the zero percent or less threshold for the loan repayment rate calculations.

We estimate that it will take institutional staff 20 hours to review the listing of students included in the initial loan repayment rate calculations. We estimate that it will take institutional staff another 35 hours to review the draft loan repayment rate produced by the Secretary when challenging the accuracy of the information used to calculate that draft rate. We are estimating a total of 55 hours burden per institution for institutional activities under proposed §668.41(h)(5).

We estimate that it will take proprietary institutions a total of 27,115 hours (493 institutions x 55 hours) for an initial review and subsequent challenge to information used in the calculation of the institution's repayment rate.

For §668.41(h)(5), the total increase in burden related to the calculation, issuance, and challenges of the loan repayment rate will be 27,115 hours under OMB Control Number 1845-0004.

There will be burden on schools to deliver the loan repayment warning and the financial repayment disclosure to enrolled and prospective students under this proposed regulation.

For the loan repayment warning, under proposed §668.41(h)(7)(i), the Department commits to consumer test the language of the warning, which the Secretary will publish in a Federal Register notice. We anticipate that it will take proprietary institutions a total of 32,045 hours (493 institutions x 65 hours) to produce and provide the loan repayment warnings to current and prospective students, ensure that promotional materials include the warning, and update the institution’s Web site.

For §668.41(h)(7), the total increase in burden related to the production and dissemination of the loan repayment warnings is 32,045 hours under OMB Control Number 1845-0004.

For the financial protection disclosure, we estimate that it will take institutions an additional 50 hours to produce and provide the required financial protection disclosures to current and prospective students and update the institution’s Web site. We estimate that 169 private institutions may have 2 events requiring such reporting for a total burden of 16,900 hours (169 institutions x 2 events x 50 hours). We estimate that 392 proprietary institutions may have 3 events requiring such reporting for a total burden of 58,800 hours (392 institutions x 3 events x 50).

For §668.41(i), the total increase in burden related to the production and dissemination of the financial protection disclosures is 75,700 hours under OMB Control Number 1845-0004.

The combined total increase in burden under OMB Control Number 1845-0004 for proposed §668.41 will be 134,860 hours.

Financial responsibility.

General (34 CFR 668.171).

Requirements:

Under proposed §668.171(d), in accordance with procedures to be established by the Secretary, an institution would notify the Secretary of any action or triggering event described in proposed §668.171(c) no later than 10 days after that action or event occurs.

In that notice, the institution may show that certain actions or events are not material or that those actions are resolved. Specifically:

- The institution may explain why a judicial or administrative proceeding the institution disclosed to the SEC does not constitute a material event.

- The institution may demonstrate that a withdrawal of owner's equity was used solely to meet tax liabilities of the institution or its owners. Or, where the composite score is calculated based on the consolidated financial statements of a group of institutions, the amount withdrawn from one institution in the group was transferred to another entity within that group.

- The institution may show that the creditor waived a violation of a loan agreement. If the creditor imposes additional constraints or requirements as a condition of waiving the violation and continuing with the loan, the institution must identify and describe those constraints or requirements. In addition, if a default or delinquency event occurs or other events occur that trigger, or enable the creditor to require or impose, additional constraints or penalties on the institution, the institution would be permitted to show why these actions would not have an adverse financial impact on the institution.

Burden Calculation:

There will be burden on schools to provide the notice to the Secretary when one of the actions or triggering events identified in §668.171(c) occurs. We estimate that an institution will take two hours per action or triggering event to prepare the appropriate notice and provide it to the Secretary. We estimate that 169 private institutions may have 2 events annually to report for a total burden of 676 hours (169 institutions x 2 events x 2 hours). We estimate that 392 proprietary institutions may have 3 events annually to report for total burden of 2,352 hours (392 institutions x 3 events x 2 hours). We estimate that 91 public institutions may have 1 event annually to report for a total burden of 182 hours (91 institutions x 1 event x 2 hours). This total burden of 3,210 hours will be assessed under OMB Control Number 1845-0022.

Alternative standards and requirements (34 CFR 668.175).

Requirements:

Under the provisional certification alternative in §668.175, we propose to add a new paragraph (f)(4) that ties the amount of the financial protection that an institution must submit to the Secretary to an action or triggering event described in proposed §668.171(c). Specifically, under this alternative, an institution would be required to provide the Secretary financial protection, such as an irrevocable letter of credit, for an amount that is:

- For a State or Federal action under proposed §668.171(c)(1)(i)(A) or (B), 10 percent or more, as determined by the Secretary, of the amount of Direct Loan program funds received by the institution during its most recently completed fiscal year; and
- For repayments to the Secretary for losses from borrower defense claims under proposed §668.171(c)(2), the greatest annual loss incurred by the Secretary during the three most recently completed award years to resolve those claims or the amount of losses incurred by the Secretary

during the most recently completed award year, whichever is greater, plus a portion of the amount of any outstanding or pending claims based on the ratio of the total value of claims resolved in favor of borrowers during the three most recently completed award years to the total value of claims adjudicated during the three most completed award years;

- For any other action or triggering event described in proposed §668.171(c), if the institution's composite score is less than 1.0, or the institution no longer qualifies under the zone alternative, 10 percent or more, as determined by the Secretary, of the total amount of title IV, HEA program funds received by the institution during its most recently completed fiscal year.

Burden Calculation:

There will be burden on schools to provide the required financial protection, such as a letter of credit, to the Secretary to utilize the provisional certification alternative. We estimate that an institution will take 40 hours per action or triggering event to obtain the required financial protections and provide it to the Secretary. We estimate that 169 private not-for-profit institutions may have 2 events annually to report for a total burden of 13,520 hours (169 institutions x 2 events x 40 hours). We estimate that 392 proprietary institutions may have 3 events annually to report for total burden of 47,040 hours (392 institutions x 3 events x 40 hours). We estimate that 91 public institutions may have 1 event annually to report for a total burden of 3,640 hours (91 institutions x 1 event x 40 hours). This total burden of 64,200 hours will be assessed under OMB Control Number 1845-0022.

The combined total increase in burden under OMB Control Number 1845-0004 for proposed §668.41 will be 134,860 (27,115 + 32,045 + 75,700) hours.

The combined total increase in burden under OMB Control Number 1845-0022 for proposed §668.14, §668.171, and §668.175 will be 69,271 (1,861 + 3,210 + 64,200) hours.

Mandatory administrative forbearance for FFEL Program borrowers (§682.211).

Requirements:

Under proposed §682.211(i)(7), a lender would be required to grant a mandatory administrative forbearance to a borrower upon being notified by the Secretary that the borrower has submitted an application for a borrower defense discharge related to a FFEL Loan that the borrower intends to pay off through a Direct Loan Program Consolidation Loan for the purpose of obtaining relief under proposed §685.212(k). The administrative forbearance would remain in effect until the Secretary notifies the lender that a determination has been made as to the borrower's eligibility for a borrower defense discharge. If the Secretary notifies the borrower that the borrower would qualify for a borrower defense discharge if the borrower were to consolidate, the borrower would then be able to consolidate the loan(s) to which the defense applies and, if the borrower were to do so, the Secretary would recognize the defense and discharge that portion of the Consolidation Loan that paid off the FFEL Loan in question.

Burden Calculation:

There will be burden for the current 1,446 FFEL lenders to track the required mandatory administrative forbearance when they are notified by the Secretary of the borrower's intention to enter their FFEL Loans into a Direct Consolidation Loan to obtain a borrower defense discharge. We estimate that it will take each lender approximately four hours to develop and program the needed tracking into their current systems. There will be an estimated burden of 5,480 hours on the 1,370 for-profit lenders (1,370 x 4 = 5,480 hours). There will be an estimated burden of 304 hours on the 76 not-for-profit lenders (76 x 4 = 304 hours). The total burden of 5,784 hours will be assessed under OMB Control Number 1845-0020.

Closed school discharges--§682.402.

Requirements:

Proposed §682.402(d)(6)(ii)(F) would provide a second level of Departmental review for denied closed school discharge claims in the FFEL Program. 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.

Proposed §682.402(d)(6)(ii)(I) would require the guaranty agency or the Department, upon resuming collection, to provide a FFEL borrower with another closed school discharge application, and an explanation of the requirements and procedures for obtaining the discharge.

Proposed §682.402(d)(6)(ii)(K) would describe the responsibilities of the guaranty agency if the borrower requests such a review.

Proposed §682.402(d)(8)(iii) would authorize the Department, or a guaranty agency with the Department's permission, to grant a closed school discharge to a FFEL borrower without a borrower application based on information in the Department's or guaranty agency's possession that the borrower did not subsequently re-enroll in any title IV-eligible institution within a period of three years after the school closed.

Burden Calculation:

There will be burden on guaranty agencies to provide information to borrowers denied closed school discharge regarding the opportunity for further review of the discharge request by the Secretary. We estimate that it will take the 27 guaranty agencies 4 hours to update their notifications and establish a process for forwarding any requests for escalated reviews to the Secretary. There will be an estimated burden of 68 hours on the 17 public guaranty agencies (17 x 4 hours = 68 hours). There will be an estimated burden of 40 hours on the 10 not-for-profit guaranty agencies (10 x 4 hours = 40 hours). The total burden of 108 hours will be assessed under OMB Control Number 1845-0020.

There will be burden on guaranty agencies to, upon receipt of the request for escalated review from the borrower, forward to the Secretary the discharge form and any relevant documents. For the period between 2011 and 2015 there were 43,268 students attending closed schools, of which 9,606 students received a closed school discharge.

It is estimated that 5 percent of the 43,268, or 2,163, closed school applications were denied. We estimate that 10 percent or 216 of those borrowers whose application was denied will request escalated review by the Secretary. We estimate that the process to forward the discharge request and any relevant documentation to the Secretary will take .5 hours (30 minutes) per request. There will be an estimated burden of 58 hours on the 17 public guaranty agencies based on an estimated 116 requests (116 X .5 hours = 58 hours). There will be an estimated burden of 50 hours on the 10 not-for-profit guaranty agencies (100 x .5 hours = 50 hours). The total burden of 108 hours will be assessed under OMB Control Number 1845-0020.

The guaranty agencies will have burden assessed based on these proposed regulations to provide another discharge application to a borrower upon resuming collection activities with explanation of process and requirements for obtaining a discharge. We estimate that for the 2,163 closed school applications that were denied, it will take the guaranty agencies .5 hours (30 minutes) to provide the borrower with another discharge application and instructions for filing the application again. There will be an estimated burden of 582 hours on the 17 public guaranty agencies based on an estimated 1,163 borrowers

(1,163 x .5 hours = 582 hours). There will be an estimated burden of 500 hours on the 10 not-for-profit guaranty agencies (1,000 x .5 hours = 500 hours). The total burden of 1,082 will be assessed under OMB Control Number 1845-0020.

There will be burden assessed the guaranty agencies to determine the eligibility of a borrower for a closed school discharge without the borrower submitting such an application. This requires a review of those borrowers who attended a closed school but did not apply for a closed school discharge to determine if the borrower re-enrolled in any other institution within three years of the school closure. We estimate that there will be 20 hours of programming to allow for a guaranty agency to establish a process to review its records for borrowers who attended a closed school and to determine if any of those borrowers reenrolled in a title IV-eligible institution within three years. There will be an estimated burden of 340 hours on the 17 public guaranty agencies for this programming (17 x 20 hours = 340 hours rounded up). There will be an estimated burden of 200 hours on the not-for-profit guaranty agencies for this programming (10 x 20 hours = 200 hours). The total burden of 540 hours will be assessed under OMB Control Number 1845-0020.

The total burden of 1,838 hours for §682.402 will be assessed under OMB Control Number 1845-0020.

The combined total increase in burden under OMB Control Number 1845-0020 for proposed §682.211 and §682.402 will be 7,622 hours (5,784 + 108 + 540 + 108 + 1,082).

Process for individual borrowers (34 CFR 685.222(e)).

Requirements:

Proposed §685.222(e)(1) would describe the steps an individual borrower must take to initiate a borrower defense claim. First, an individual borrower would submit an application to the Secretary, on a form approved by the Secretary. In the application, the borrower would certify that he or she received the proceeds of a loan to attend a school; may provide evidence that supports the borrower defense; and would indicate whether he or she has made a claim with respect to the information underlying the borrower defense with any third party, and, if so, the amount of any payment received by the borrower or credited to the borrower's loan obligation. The borrower would also be required to provide any other information or supporting documentation reasonably requested by the Secretary.

While the decision of the Department official would be final as to the merits of the claim and any relief that may be warranted on the claim, if the borrower defense is denied in full or in part, the borrower would be permitted to request that the Secretary reconsider the borrower defense upon the identification of new evidence in support of the borrower's claim. "New evidence" would be defined as relevant evidence that the borrower did not previously provide and that was not identified by the Department official as evidence that was relied upon for the final decision.

Burden Calculation:

There will be burden associated with the filing of the Departmental form by the borrower asserting a borrower defense claim. We are conducting a separate information collection review process for the proposed form to provide for public comment on the form as well as the estimated burden. A separate information collection review package will be published in the Federal Register and available through Regulations.gov for review and comment.

Additionally there will be burden on any borrower whose borrower defense claim is denied, if they elect to request reconsideration from the Secretary based on new evidence in support of the borrower's claim. We estimate that two percent of borrower defense claims received would be denied and those borrowers would then request reconsideration by presenting new evidence to support their claim. As of April 27, 2016, 18,688 borrower defense claims had been received. Of that number, we estimate that 467 borrowers, including those that opt out of a successful borrower defense group relief, would require .5 hours (30 minutes) to submit the request for reconsideration to the Secretary for a total of 234 burden hours (467 x .5 hours). This burden will be assessed under OMB Control Number 1845-NEW.

Group process for borrower defenses--General (34 CFR 685.222(f)).

Requirements:

Proposed §685.222(f) would provide a framework for the borrower defense group process, including descriptions of the circumstances under which group borrower defense claims could be considered, and the process the Department would follow for borrower defenses for a group.

Once a group of borrowers with common facts and claims has been identified, the Secretary would designate a Department official to present the group's common borrower defense in the fact-finding process, and would provide each identified member of the group with notice that allows the borrower to opt out of the proceeding.

Burden Calculation:

There will be burden on any borrower who elects to opt out of the group process after the Secretary has identified them as a member of a group for purposes of borrower defense. We estimate that one percent of borrowers who are identified as part of a group process for borrower defense claims would opt out of the group claim process. As of April 27, 2016, 18,688 borrower defense claims had been received. Of that number, we estimate that 187 borrowers would require .08 hours (5 minutes) to submit the request to opt out of the group process to the Secretary for a total of 15 burden hours (187 x .08 hours). This burden will be assessed under OMB Control Number 1845-NEW.

Group process for borrower defense--Closed school (34 CFR 685.222(g)).

Requirements:

Section 685.222(g) of the proposed regulations would establish a process for review and determination of a borrower defense for groups identified by the Secretary for which the borrower defense is made with respect to Direct Loans to attend a school that has closed and has provided no financial protection currently available to the Secretary from which to recover any losses based on borrower defense claims, and for which there is no appropriate entity from which the Secretary can otherwise practicably recover such losses.

Under proposed §685.222(g)(1), a hearing official would review the Department official's basis for identifying the group and resolve the claim through a fact-finding process. As part of that process, the hearing official would consider any evidence and argument presented by the Department official on behalf of the group and on behalf of individual members of the group. The hearing official would consider any additional information the Department official considers necessary, including any Department records or response from the school or a person affiliated with the school as described §668.174(b) as reported to the Department or as recorded in the Department's records if practicable.

<u>Burden Calculation</u>:

There will be burden on any school which elects to provide records or response to the hearing official's fact finding. We anticipate that each group would represent a single institution. We estimate that there will be four potential groups involving closed schools. We estimate that the fact-finding process would require 50 hours from 1 private closed school or persons affiliated with that closed school (1 private institution x 50 hours). We estimate that the fact-finding process would require 150 hours from 3 proprietary closed schools or persons affiliated with that closed school (3 proprietary institutions x 50 hours). We estimate the burden to be 200 hours (4 institutions x 50 hours). This burden will be assessed under OMB Control Number 1845-NEW.

Group process for borrower defense--Open school (34 CFR 685.222(h)).

Requirements:

Proposed §685.222(h) would establish the process for groups identified by the Secretary for which the borrower defense is asserted with respect to Direct Loans to attend an open school.

A hearing official would resolve the borrower defense and determine any liability of the school through a fact-finding process. As part of the process, the hearing official would consider any evidence and argument presented by the school and the Department official on behalf of the group and, as necessary, evidence presented on behalf of individual group members.

The hearing official would issue a written decision. If the hearing official approves the borrower defense, that decision would describe the basis for the determination, notify the members of the group of the relief provided on the basis of the borrower defense, and notify the school of any liability to the Secretary for the amounts discharged and reimbursed.

If the hearing official denies the borrower defense in full or in part, the written decision would state the reasons for the denial, the evidence that was relied upon, the portion of the loans that are due and payable to the Secretary, and whether reimbursement of amounts previously collected is granted, and would inform the borrowers that their loans will return to their statuses prior to the group borrower defense process. It also would notify the school of any liability to the Secretary for any amounts discharged. The Secretary would provide copies of the written decision to the members of the group, the Department official and the school.

The hearing official's decision would become final as to the merits of the group borrower defense claim and any relief that may be granted within 30 days after the decision is issued and received by the Department official and the school unless, within that 30-day period, the school or the Department official appeals the decision to the Secretary. A decision of the hearing official would not take effect pending the appeal. The Secretary would render a final decision following consideration of any appeal.

After a final decision has been issued, if relief for the group has been denied in full or in part, a borrower may file an individual claim for relief for amounts not discharged in the group process. In addition, the Secretary may reopen a borrower defense application at any time to consider new evidence, as discussed above.

Burden Calculation:

There will be burden on any school that provides evidence and responds to any argument made to the hearing official’s fact finding and if the school elects to appeal the final decision of the hearing official regarding the group claim. We anticipate that each group would represent claims from a single institution. We estimate that there will be six potential groups involving open schools. We estimate that the fact-finding process would require 150 hours from the 3 open private institutions or persons affiliated with that school (3 institutions x 50 hours). We estimate that the fact-finding process would require 150 hours from the 3 open proprietary institutions or persons affiliated with that school (3 institutions x 50 hours). We estimate the burden to be 300 hours (6 institutions x 50 hours).

We further estimate that the appeal process would require 150 hours from the 3 open private institutions or persons affiliated with that school (3 institutions x 50 hours). We estimate that the appeal process would require 150 hours from the 3 open proprietary institutions or persons affiliated with that school (3 institutions x 50 hours). We estimate the burden to be 300 hours (6 institutions x 50 hours). The total estimated burden for this section will be 600 hours assessed under OMB Control Number 1845-NEW.

Additionally, any borrower whose borrower defense claim is denied under the group claim may request reconsideration based on new evidence to support the individual claim. We believe that the estimate for the total universe of denied claims in §685.222(e) includes these borrowers.

The combined total increase in burden under OMB Control Number 1845-NEW for proposed §685.222 will be 1,049 hours (234 + 15 + 200 + 600).

Section 685.300--Agreements between an eligible school and the Secretary for participation in the Direct Loan Program.

Requirements:

Proposed §685.300(e) requires institutions that, after the effective date of the proposed regulations, incorporate pre-dispute arbitration or any other pre-dispute agreement addressing class actions in any agreements with Direct Loan Program borrowers to include specific language regarding a borrower's right to file or be a member of a class action suit against the institution when the class action concerns acts or omissions surrounding the making of the Direct Loan or provision of educational services purchased with the Direct Loan. Additionally, in the case of institutions that, prior to the effective date of the proposed regulations, incorporated pre-dispute arbitration or any other pre-dispute agreement addressing class actions in any agreements with Direct Loan Program borrowers, the proposed regulations would require institutions to provide to borrowers agreements or notices with specific language regarding a borrower's right to file or be a member of a class action suit against the institution when the class action concerns acts or omissions surrounding the making of the Direct Loan or provision of educational services purchased with the Direct Loan. Institutions would be required to provide such notices or agreements to such borrowers no later than at the time of the loan exit counseling for current students or the date the school files an initial response to an arbitration demand or complaint suit from a student who hasn’t received such agreement or notice.

Proposed §685.300(f) would require institutions that, after the effective date of the proposed regulations, incorporate pre-dispute arbitration agreements with Direct Loan Program borrowers to include specific language regarding a borrower’s right to file a lawsuit against the institution when it concerns acts or omissions surrounding the making of the Direct Loan or provision of educational services purchased with the Direct Loan. Additionally, in the case of institutions that, prior to the effective date of the proposed regulations, incorporated pre-dispute arbitration agreements with Direct Loan Program borrowers, the proposed regulations would require institutions to provide to borrowers agreements or notices with specific language regarding a borrower’s right to file a lawsuit against the institution when the class action concerns acts or omissions surrounding the making of the Direct Loan or provision of educational services purchased with the Direct Loan. Institutions would be required to provide such agreements or notices to such borrowers no later than at the time of the loan exit counseling for current students or the date the school files an initial response to an arbitration demand or complaint suit from a student who hasn’t received such agreement or notice.

Burden Calculation:

There will be burden on any school that meets the conditions for supplying students with the changes to any agreements. Based on the AY 2014-2015 Direct Loan information available, there were 1,528,714 Unsubsidized Direct Loan recipients at proprietary institutions. Assuming 66 percent of these students would continue to be enrolled at the time these regulations become effective there would be 1,008,951 students who would be required to receive the agreements or notices required by proposed §685.300(e) or (f). We anticipate that it will take proprietary institutions .17 hours (10 minutes) per student to research who is required to receive these agreements or notices, prepare them, and forward the information accordingly for a total burden of 171,522 hours (1,008,951 students x .17 hours) assessed under OMB Control Number 1845-NEW2.

Requirements:

Proposed §685.300(g) requires institutions to provide to the Secretary copies of specified records connected to a claim filed in arbitration by or against the school regarding a borrower defense claim. The school must submit any records within 60 days of the filing by the school of such records to an arbitrator or upon receipt by the school of such records that were filed by someone other than the school, such as an arbitrator or student regarding a claim.

Proposed §685.300(h) requires institutions to provide to the Secretary copies of specified records connected to a claim filed in a lawsuit by the school, a student, or any party against the school regarding a borrower defense claim. The school must submit any records within 30 days of the filing or receipt of the complaint by the school or upon receipt by the school of rulings on a dipositive motion or final judgement.

Burden Calculation:

There will be burden on any school that must provide to the Secretary copies of specified records connected to a claim filed in arbitration by or against the school regarding a borrower defense claim. We estimate that 5 percent of the 1,959 proprietary schools, or 98 schools, would be required to submit documentation to the Secretary to comply with the proposed regulations. We anticipate that each of the 98 schools would have an average of 4 filings, with an average of four submissions for each filing. Because these are copies of documents required to be submitted to other parties we anticipate 5 burden hours to produce the copies and submit to the Secretary for a total of 7,840 hours (98 institutions x 4 filings x 4 submissions/filing x 5 hours) assessed under OMB Control Number 1845-NEW2.

The combined total increase in burden under OMB Control Number 1845-NEW2 for proposed §685.300 will be 179,362 hours (171,522 + 7,840).

Consistent with the discussion 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 costs of the increased burden on institutions, lenders, guaranty agencies, and borrowers, using wage data developed using BLS data, available at www.bls.gov/ncs/ect/sp/ecsuphst.pdf, is $ 14,328,558 as shown in the chart below. This cost was based on an hourly rate of $36.55 for institutions, lenders, and guaranty agencies and $16.30 for borrowers.

Collection of Information

Regulatory Section	Information Collection	OMB Control Number and Estimated Burden [change in burden]	Estimated Costs
§668.14 - Program participation agreement.	The proposed regulation would require, as part of the program participation agreement, a school to provide to all enrolled students with a closed school discharge application and a written disclosure, describing the benefits and the consequences of a closed school discharge as an alternative to completing their educational program through a teach-out plan after the Department initiates any action to terminate the participation of the school in any title IV, HEA program or after the occurrence of any of the events specified in §668.14(b)(31) that would require the institution to submit a teach-out plan.	1845-0022 – This would be a revised collection. We estimate burden would increase by 1,861 hours.	$68,025

§668.41 – Reporting and disclosure of information.	The proposed regulation would provide that, for any fiscal year in which a proprietary institution's loan repayment rate is zero percent or less, the institution must provide a warning to enrolled and prospective students about that institution's repayment outcomes. If an institution is required to provide financial protection to the Secretary, such as an irrevocable letter of credit or cash under §668.175(d) or (f), or to establish a set-aside under §668.175(h), the institution must disclose that protection to enrolled and prospective students.	1845-0004 – This would be a revised collection. We estimate burden would increase by 134,860 hours.	$ 4,929,133

§668.171 - Financial responsibility - General	The proposed regulations add a new paragraph (d) under which, in accordance with procedures to be established by the Secretary, an institution would notify the Secretary of any action or triggering event described in §668.171(c) no later than 10 days after that action or event occurs.	1845-0022 – This would be a revised collection. We estimate burden would increase by 3,210 hours.	$117,326

§668.175 - Alternative standards and requirements	The proposed regulations would add a new paragraph (f)(4) that ties the amount of the letter of credit that an institution must submit to the Secretary to an action or triggering event described in §668.171(c).	1845-0022 – This would be a revised collection. We estimate burden would increase by 64,200 hours.	$2,346,510

§682.211 – Forbearance.	The proposed regulations would add a new paragraph §682.211(i)(7) that requires a lender to grant a mandatory administrative forbearance to a borrower upon being notified by the Secretary that the borrower has submitted an application for a borrower defense discharge related to a FFEL Loan that the borrower intends to pay off through a Direct Loan Program Consolidation Loan for the purpose of obtaining relief under proposed §685.212(k).	1845-0020 – This would be a revised collection. We estimate burden would increase by 5,784 hours.	$211,405

§682.402 - Death, disability, closed school, false certification, unpaid refunds, and bankruptcy payments.	The proposed regulations would provide a second level of Departmental review for denied closed school discharge claims in the FFEL Program. The proposed language 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 Department, and an explanation of how the borrower may request such a review. The proposed regulations would require the guaranty agency or the Department, upon resuming collection, to provide a FFEL borrower with another closed school discharge application, and an explanation of the requirements and procedures for obtaining the discharge. The proposed regulations would describe the responsibilities of the guaranty agency if the borrower requests such a review. The proposed regulations would authorize the Department, or a guaranty agency with the Department's permission, to grant a closed school discharge to a FFEL borrower without a borrower application based on information in the Department's or guaranty agency's possession that	1845-0020 – This would be a revised collection. We estimate burden would increase by 1,838 hours.	$67,179

	the borrower did not subsequently re-enroll in any title IV-eligible institution within a period of three years after the school closed.		

§685.222 - Borrower defenses	The proposed regulation would describe the steps an individual borrower must take to initiate a borrower defense claim. The proposed regulations also would provide a framework for the borrower defense group process, including descriptions of the circumstances under which group borrower defense claims could be considered, and the process the Department would follow for borrower defenses for a group. The proposed regulations would establish a process for review and determination of a borrower defense for groups identified by the Secretary for which the borrower defense is made with respect to Direct Loans to attend a school that has closed and has provided no financial protection currently available to the Secretary from which to recover any losses based on borrower defense claims, and for which there is no appropriate entity from which the Secretary can otherwise practicably recover such losses. The proposed regulation would establish the process for groups identified by the Secretary for which the borrower defense is asserted with respect to Direct Loans to attend an open school.	1845-NEW - This would be a new collection. We estimate burden would increase by 1,049 hours.	$ 33,299

685.300 Agreements between an eligible school and the Secretary for participation in the Direct Loan Program.	The proposed regulations would require institutions, following the effective date of the regulations, to incorporate language into agreements allowing participation by Direct Loan students in class action lawsuits as well as pre-dispute arbitration agreements. There is required agreement and notification language to be provided to affected students. Additionally, the proposed regulations would require institutions to submit to the Secretary copies of arbitral records and judicial records within specified timeframes when the actions concern a borrower defense claim.	1845-NEW2 – This would be a new collection. We estimate burden would increase by 179,362 hours	$6,555,681

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

Control number	Total Proposed Burden Hours	Proposed Change in Burden Hours
1845-0004	153,530	134,860
1845-0020	8,249,520	+7,622
1845-0022	2,285,241	+69,271
1845-NEW	1,049	+1,049
1845-NEW2	179,362	+179,362
Total	10,868,702	+392,164

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

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 NPRM. These proposed collections are identified as proposed collections 1845-0004, 1845-0020, 1845-0022, 1845-NEW, and 1845-NEW2.

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 [INSERT DATE 30 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER]. 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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(Catalog of Federal Domestic Assistance Number does not apply.)

List of Subjects

34 CFR Part 30

Claims, Income taxes.

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.

34 CFR Part 686

Administrative practice and procedure, Colleges and universities, Education, Elementary and secondary education, Grant programs-education, Reporting and recordkeeping requirements, Student aid.

Dated: June 9, 2016

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John B. King, Jr.
Secretary of Education.

For the reasons discussed in the preamble, the Secretary of Education proposes to amend parts 30, 668, 674, 682, 685, and 686 of title 34 of the Code of Federal Regulations as follows:

PART 30--DEBT COLLECTION

1. The authority citation for part 30 continues to read as follows:

AUTHORITY: 20 U.S.C. 1221e-3(a)(1), and 1226a-1, 31 U.S.C. 3711(e), 31 U.S.C. 3716(b) and 3720A, unless otherwise noted.

2. Section 30.70 is revised to read as follows:

§30.70 How does the Secretary exercise discretion to compromise a debt or to suspend or terminate collection of a debt?

(a)(1) The Secretary uses the standards in the FCCS, 31 CFR part 902, to determine whether compromise of a debt is appropriate if the debt arises under a program administered by the Department, unless compromise of the debt is subject to paragraph (b) of this section.

(2) If the amount of the debt is more than $100,000, or such higher amount as the Department of Justice may prescribe, the Secretary refers a proposed compromise of the debt to the Department of Justice for approval, unless the compromise is subject to paragraph (b) of this section

or the debt is one described in paragraph (e) of this section.

(b) Under the provisions in 34 CFR 81.36, the Secretary may enter into certain compromises of debts arising because a recipient of a grant or cooperative agreement under an applicable Department program has spent some of these funds in a manner that is not allowable. For purposes of this section, neither a program authorized under the Higher Education Act of 1965, as amended (HEA), nor the Impact Aid Program is an applicable Department program.

(c)(1) The Secretary uses the standards in the FCCS, 31 CFR part 903, to determine whether suspension or termination of collection action on a debt is appropriate.

(2) Except as provided in paragraph (e), the Secretary--

(i) Refers the debt to the Department of Justice to decide whether to suspend or terminate collection action if the amount of the debt outstanding at the time of the referral is more than $100,000 or such higher amount as the Department of Justice may prescribe; or

(ii) May suspend or terminate collection action if the amount of the debt outstanding at the time of the Secretary’s determination that suspension or termination is warranted is less than or equal to $100,000 or such higher amount as the Department of Justice may prescribe.

(d) In determining the amount of a debt under paragraph (a), (b), or (c) of this section, the Secretary deducts any partial payments or recoveries already received, and excludes interest, penalties, and administrative costs.

(e)(1) Subject to paragraph (e)(2) of this section, under the provisions of 31 CFR part 902 or 903, the Secretary may compromise a debt in any amount, or suspend or terminate collection of a debt in any amount, if the debt arises under the Federal Family Education Loan Program authorized under title IV, part B, of the HEA, the William D. Ford Federal Direct Loan Program authorized under title IV, part D of the HEA, or the Perkins Loan Program authorized under title IV, part E, of the HEA.

(2) The Secretary refers a proposed compromise, or suspension or termination of collection, of a debt that exceeds $1,000,000 and that arises under a loan program described in paragraph (e)(1) of this section to the Department of Justice for review. The Secretary does not compromise, or suspend or terminate collection of, a debt referred to the Department of Justice for review until the

Department of Justice has provided a response to that request.

(f) The Secretary refers a proposed resolution of a debt to the Government Accountability Office (GAO) for review and approval before referring the debt to the Department of Justice if--

(1) The debt arose from an audit exception taken by GAO to a payment made by the Department; and

(2) The GAO has not granted an exception from the GAO referral requirement.

(g) Nothing in this section precludes--

(1) A contracting officer from exercising his authority under applicable statutes, regulations, or common law to settle disputed claims relating to a contract; or

(2) The Secretary from redetermining a claim.

(h) Nothing in this section authorizes the Secretary to compromise, or suspend or terminate collection of, a debt--

(1) Based in whole or in part on conduct in violation of the antitrust laws; or

(2) Involving fraud, the presentation of a false claim, or misrepresentation on the part of the debtor or any party having an interest in the claim.

(Authority: 20 U.S.C. 1082(a) (5) and (6), 1087a, 1087hh, 1221e-3(a)(1), 1226a-1, and 1234a, 31 U.S.C. 3711)

PART 668--STUDENT ASSISTANCE GENERAL PROVISIONS

3. 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.

4. Section 668.14 is amended by:

A. In paragraph (b)(30)(ii)(C), removing the word "and".

B. In paragraph (b)(31)(v), removing the period and adding, in its place, the punctuation and word "; and".

C. Adding a new paragraph (b)(32).

The addition reads as follows:

§668.14 Program participation agreement.

* * * * *

(b) * * *

(32) The institution will provide all enrolled students with a closed school discharge application and a written disclosure, describing the benefits and consequences of a closed school discharge as an alternative to completing their educational program through a teach-out agreement, as defined in 34 CFR 602.3, immediately upon

submitting a_teach-out plan after the occurrence of any of the following events:

(i) The initiation by the Secretary of an action to terminate the participation of an institution in any title IV, HEA program under 34 CFR 600.41 or subpart G of this part or the initiation of an emergency action under §668.83; or

(ii) The occurrence of any of the events in paragraph (b)(31)(ii)-(v) of this section.

* * * * *

5. Section 668.41 is amended by:

A. Adding new paragraphs (h) and (i).

B. Revising the authority citation.

The additions and revision read as follows:

§§668.41 Reporting and disclosure of information.

* * * * *

(h) Loan repayment warning for proprietary institutions—(1) General. For any fiscal year in which a proprietary institution's loan repayment rate is equal to or less than zero, the institution must deliver a warning to enrolled and prospective students in the manner described in paragraphs (h)(7) and (8) of this section.

(2) Definitions. For purposes of this section, the term--

(i) "Fiscal year" means the 12-month period beginning on October 1 and ending on the following September 30 that is identified by the calendar year in which it ends;

(ii) "Original outstanding balance" (OOB) means the amount of the outstanding balance, including accrued interest, on the Direct Loans owed by a student for enrollment at the institution on the date the loans first entered repayment. The OOB does not include PLUS loans made to parent borrowers or TEACH Grant-related loans. For consolidation loans, the OOB includes only those loans attributable to the borrower's enrollment at the institution;

(iii) "Current outstanding balance" (COB) means the amount of the outstanding balance, including capitalized and uncapitalized interest, on the Direct Loans owed by the student at the end of the most recently completed fiscal year; and

(iv) "Measurement period" is the period of time between the date that a borrower's loan enters repayment and the end of the fiscal year for which the COB of that loan is determined.

(3) Methodology. For each fiscal year, the Secretary calculates an institution's loan repayment rate for the cohort of borrowers whose Direct Loans entered repayment at

any time during the fifth fiscal year prior to the most recently completed fiscal year by--

(i) Determining the OOB of the loans for each of those borrowers;

(ii) Determining the COB of the loans for each of those borrowers;

(iii) Calculating the difference between the OOB and the COB of the loans for each of those borrowers and expressing that difference as a percentage reduction of, or an increase in, the OOB;

(iv) Using zero as the value for any loan on which the borrower defaulted for which there is a percentage reduction of the OOB; and

(v) On a scale where percentage reductions in principal are positive values and percentage increases in principal are negative values, determining the median value. The median value is the loan repayment rate for that fiscal year.

(4) Exclusions. The Secretary excludes a borrower from the calculation of the loan repayment rate if--

(i) One or more of the borrower's loans were in a military-related deferment status during the last fiscal year of the measurement period;

(ii) One or more of the borrower's loans are either under consideration by the Secretary, or have been approved, for a discharge on the basis of the borrower's total and permanent disability, under §685.213;

(iii) The borrower was enrolled in an eligible institution during the last fiscal year of the measurement period; or

(iv) The borrower died.

(5) Issuing and correcting loan repayment rates. In accordance with procedures established by the Secretary--

(i) Before issuing a final loan repayment rate for a fiscal year, the Secretary--

(A) Provides to the institution a list of the students in the cohort described in paragraph (h)(3) of this section, the draft repayment rate for that cohort, and the information used to calculate the draft rate; and

(B) Allows 45 days for the institution to challenge the accuracy of the information that the Secretary used to calculate the draft rate; and

(ii) After considering any challenges to the draft loan repayment rate, the Secretary notifies the institution of its final repayment rate.

(iii) If an institution’s final loan repayment rate is equal to or less than zero--

(A) Using the calculation described in paragraph (h)(6)(ii) of this section, the institution may submit an appeal to the Secretary within 15 days of receiving notification of its final repayment rate; and

(B) The Secretary will notify the institution if the appeal is accepted and the institution qualifies for an exemption from the warning requirement under paragraph (h)(7) of this section.

(6) Privacy and low borrowing considerations. An institution is not required to deliver a warning under paragraph (h)(7) of this section based on a final repayment rate for that fiscal year if the institution demonstrates to the Secretary's satisfaction that--

(i) That rate is based on fewer than 10 borrowers in the cohort described in paragraph (h)(3) of this section; or

(ii) The institution's participation rate index is less than or equal to 0.0625. An institution calculates its participation rate index as if its cohort default rate were 30 percent, using the formula described in §668.214(b)(1).

(7) Student warnings — (i) General. An institution must deliver the warning required under this section to enrolled and prospective students in a form and manner

prescribed by the Secretary in a notice published in the Federal Register. Before publishing that notice, the Secretary will conduct consumer testing to help ensure that the warning is meaningful and helpful to students.

(ii) Delivery to enrolled students. An institution must deliver the warning required under this section by notifying each enrolled student in writing no later than 30 days after the Secretary informs the institution of its final loan repayment rate by--

(A)(1) Hand-delivering the warning as a separate document to the student individually or as part of a group presentation; or

(2) Sending the warning to the student's primary email address or delivering the warning through the electronic method used by the institution for communicating with the student about institutional matters; and

(B) Ensuring that the warning is the only substantive content in the message sent to the student under this paragraph unless the Secretary specifies additional, contextual language to be included in the message.

(iii) Delivery to prospective students. An institution must provide the warning required under this paragraph (h) to a prospective student before that student enrolls, registers, or enters into a financial obligation with the institution by--

(A)(1) Hand-delivering the warning as a separate document to the student individually, or as part of a group presentation; or

(2) Sending the warning to the student's primary email address or delivering the warning through the electronic method used by the institution for communicating with prospective students about institutional matters; and

(B) Ensuring that the warning is the only substantive content in the message sent to the student under this paragraph unless the Secretary specifies additional, contextual language to be included in the message.

(8) Promotional materials. (i) If an institution is required to deliver a warning under paragraph (h)(1) of this section, it must, in all promotional materials that are made available to prospective or enrolled students by or on behalf of the institution, include the warning under paragraph (h)(7) of this section, in a prominent manner.

(ii) Promotional materials include, but are not limited to, an institution's Web site, catalogs, invitations, flyers, billboards, and advertising on or through radio, television, print media, social media, or the Internet.

(iii) The institution must ensure that all promotional materials, including printed materials, about the institution are accurate and current at the time they are published, approved by a State agency, or broadcast.

(9) Institutional Web site. (i) An institution must prominently provide the warning required in this section in a simple and meaningful manner on the home page of the institution's Web site.

(ii) The warning must be posted to the institution's Web site no later than 30 days after the date the Secretary informs the institution of its final loan repayment rate, and remain posted to that Web site for the 12-month period following the date on which the Secretary informs the institution of its final loan repayment rate.

(i) Financial protection disclosures. If an institution is required to provide financial protection to the Secretary, such as an irrevocable letter of credit or cash under §668.175(d) or (f), or to establish a set-aside under §668.175(h), the institution must--

(1) Disclose information about that financial protection to enrolled and prospective students in the manner described in paragraph (h)(7) of this section;

(2) Post the disclosure on the home page of the institution's Web site in the manner described in paragraph

(h)(9) of this section no later than 30 days after the date the Secretary informs the institution of the need for the institution to provide financial protection, until such time as the Secretary releases the institution from the requirement that it provide financial protection; and

(3) Identify and explain clearly in that disclosure the reason or reasons that the institution was required to provide that financial protection.

(Authority: 20 U.S.C. 1092, 1094, 1099c)

§668.71 [Amended]

6. Section 668.71 is amended by:

A. In the second sentence of the definition of "Misrepresentation" in paragraph (c), removing the word "deceive" and adding in its place the words "mislead under the circumstances".

B. In the definition of "Misrepresentation" in paragraph (c), adding a new fourth sentence, "Misrepresentation includes any statement that omits information in such a way as to make the statement false, erroneous, or misleading."

7. Section 668.90 is amended by revising paragraph (a)(3) to read as follows:

§668.90 Initial and final decisions.

(a) * * *

(3) Notwithstanding the provisions of paragraph (a)(2) of this section--

(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 in the amount specified by the Secretary under §668.15 or subpart L of part 668, the hearing official finds that the amount of the letter of credit or other financial protection established by the Secretary is appropriate, unless the institution can demonstrate that the amount was not warranted because--

(A) The events or conditions identified by the Secretary as the grounds on which the protection is required no longer exist or have been resolved in a manner that eliminates the risk they posed to the institution's ability to meet its financial obligations; or

(B) The institution has proffered alternative financial protection that provides students and the Department adequate protection against losses resulting from the risks identified by the Secretary. Adequate protection consists of one or both of the following--

(1) A deposit with the Secretary of cash in the amount of financial protection demanded by the Secretary to be held by the Secretary in escrow; or

(2) An agreement with the Secretary that a portion of the funds earned by the institution under a reimbursement funding arrangement will be temporarily withheld in such amounts as will meet, by the end of a nine-month period, the amount of the required financial protection demanded;

(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) or §668.175(g) have been met.

* * * * *

8. Section 668.93 is amended by redesignating paragraphs (h) and (i) as paragraphs (i) and (j), respectively, and adding a new paragraph (h), to read as follows:

§668.93 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).

* * * * *

9. 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) and (d) 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 otherwise provide the administrative resources necessary to comply with title IV, HEA program requirements; 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) Actions and triggering events. An institution is not able to meet its financial or administrative obligations under paragraph (b)(3) of this section if it is subject to one or more of the following actions or triggering events.

(1) Lawsuits and other actions. (i)(A) Currently or at any time during the three most recently completed award years, the institution is or was required to pay a debt or incurs a liability arising from an audit, investigation, or similar action initiated by a State, Federal, or other

oversight entity, or settles or resolves a suit brought against it by that entity, that is based on claims related to the making of a Federal loan or the provision of educational services, for an amount that, for one or more of those years, exceeds the lesser of the threshold amount for which an audit is required under 2 CFR part 200 or 10 percent of its current assets; or

(B) The institution is currently being sued by a State, Federal, or other oversight entity based on claims related to the making of a Federal loan or the provision of educational services for an amount that exceeds the lesser of the threshold amount for which an audit is required under 2 CFR part 200 or 10 percent of its current assets;

(ii) The institution is currently being sued by one or more State, Federal, or other oversight entities based on claims of any kind that are not described in paragraph (c)(1)(i)(B) of this section, and the potential monetary sanctions or damages from that suit or suits are in an amount that exceeds 10 percent of its current assets;

(iii) The institution is currently being sued in a lawsuit filed under the False Claims Act, 31 U.S.C. 3729 et seq., or by one or more private parties for claims that relate to the making of loans to students for the purpose of enrollment or the institution's provision of educational services, if that suit--

(A) Has survived a motion for summary judgment by the institution and has not been dismissed; and

(B) Seeks relief in an amount that exceeds 10 percent of the institution's current assets; or

(iv) For a suit described in paragraph (c)(1)(ii) or (iii) of this section, during a fiscal year for which the institution has not submitted its audited financial statements to the Secretary, the institution entered into a settlement, had judgment entered against it, incurred a liability, or otherwise resolved that suit for an amount that exceeds 10 percent of its current assets.

(v) In determining whether a suit or action under this paragraph exceeds the audit or percentage thresholds, the institution must--

(A) Except for private party suits under paragraph (c)(1)(iii) of this section, for a suit or action that does not demand a specific amount as relief, calculate that amount by totaling the tuition and fees the institution received from every student who was enrolled at the institution during the period for which the relief is sought, or if no period is stated, the three award years preceding the date the suit or action was filed or initiated; and

(B) Use the amount of current assets reported in its most recent audited financial statements submitted to the Secretary.

(2) Repayments to the Secretary. During the current award year or any of the three most recently completed award years, the institution is or was required to repay the Secretary for losses from borrower defense claims in an amount that, for one or more of those years, exceeds the lesser of the threshold amount for which an audit is required under 2 CFR part 200 or 10 percent of its current assets, as reported in its most recent audited financial statements submitted to the Secretary.

(3) Accrediting agency actions. Currently or any time during the three most recently completed award years, the institution is or was--

(i) Required by its accrediting agency to submit a teach-out plan, for a reason described in §602.24(c)(1), that covers the institution or any of its branches or additional locations; or

(ii) Placed on probation or issued a show-cause order, or placed on an accreditation status that poses an equivalent or greater risk to its accreditation, by its accrediting agency for failing to meet one or more of the agency's standards, and the accrediting agency does not notify the Secretary within six months of taking that action that it has withdrawn that action because the institution has come into compliance with the agency's standards.

(4) Loan agreements and obligations. As disclosed in a note to its audited financial statements or audit opinion, or reported by the institution under paragraph (d) of this section--

(i) The institution violated a provision or requirement in a loan agreement with the creditor with the largest secured extension of credit to the institution;

(ii) The institution failed to make a payment for more than 120 days in accordance with its debt obligations owed to the creditor with the largest secured extension of credit to the institution; or

(iii) As provided under the terms of a security or loan agreement between the institution and the creditor with the largest secured extension of credit to the institution, 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.

(5) Non-title IV revenue. 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).

(6) Publicly traded institutions. As reported by the institution under paragraph (d) of this section, or identified by the Secretary--

(i) The Securities and Exchange Commission (SEC) warns the institution that it may suspend trading on the institution's stock, or the institution's stock is delisted involuntarily from the exchange on which the stock was traded;

(ii) The institution disclosed or was required to disclose in a report filed with the SEC a judicial or administrative proceeding stemming from a complaint filed by a person or entity that is not part of a State or Federal action under paragraph (c)(1) of this section;

(iii) The institution failed to file timely a required annual or quarterly report with the SEC; or

(iv) The exchange on which the institution's stock is traded notifies the institution that it is not in compliance with exchange requirements.

(7) Gainful employment. As determined annually by the Secretary, the number of students who receive title IV, HEA program funds enrolled in gainful employment programs that are failing or in the zone under the D/E rates measure in §668.403(c) is more than 50 percent of the total number of students who received title IV program funds who are enrolled in all the gainful employment programs at the institution. An institution is exempt from this provision if less than 50 percent of all the students enrolled at the institution who receive title IV, HEA program funds are enrolled in gainful employment programs.

(8) Withdrawal of owner's equity. For an institution whose composite score is less than 1.5, any withdrawal of owner's equity from the institution by any means, including by declaring a dividend.

(9) Cohort default rates. 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 years, or precludes the rates from either or both years from resulting in a loss of eligibility or provisional certification.

(10) Other events or conditions. The Secretary determines that there is an event or condition that is reasonably likely to have a material adverse effect on the financial condition, business, or results of operations of the institution, including but not limited to whether--

(i) There is a significant fluctuation between consecutive award years, or a period of award years, in the amount of Direct Loan or Pell Grant funds, or a combination of those funds, received by the institution that cannot be accounted for by changes in those programs;

(ii) The institution is cited by a State licensing or authorizing agency for failing State or agency requirements;

(iii) The institution fails a financial stress test developed or adopted by the Secretary to evaluate whether the institution has sufficient capital to absorb losses that may be incurred as a result of adverse conditions and continue to meet its financial obligations to the Secretary and students;

(iv) The institution or its corporate parent has a non-investment grade bond or credit rating;

(v) As calculated by the Secretary, the institution has high annual dropout rates; or

(vii) Any adverse event reported by the institution on a Form 8-K filed with the SEC.

(d) Reporting requirements. In accordance with procedures established by the Secretary, an institution must notify the Secretary of any action or event identified in paragraph (c) of this section no later than 10 days after that action or event occurs. The Secretary may take an administrative action under paragraph (g) of this section against the institution if it fails to provide timely notice under this paragraph. In its notice to the Secretary, the institution may demonstrate that--

(1) The reported disclosure of a judicial or administrative proceeding under paragraph (c)(6)(ii) of this section does not constitute a material event;

(2) The reported withdrawal of owner's equity under paragraph (c)(8) of this section was used exclusively to meet tax liabilities of the institution

or its owners for income derived from the institution, or, in the case where the composite score is calculated based on the consolidated financial statements of a group of institutions, the amount withdrawn from one institution in the group was transferred to another entity within that group; or

(3) The reported violation of a provision or requirement in a loan agreement under paragraph (c)(4) of this section was waived by the creditor. However, if the creditor imposes additional constraints or requirements as a condition of waiving the violation, or imposes penalties or requirements under paragraph (c)(4)(iii) 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 current and future financial obligations.

(e) 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.

(f) 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 significantly bear on the institution's financial condition.

(g) 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).

(Authority: 20 U.S.C. 1094 and 1099c and section 4 of Pub. L. 95-452, 92 Stat. 1101-1109)

10. Section 668.175 is amended by:

A. Revising paragraphs (d) and (f).

B. Removing and reserving paragraph (e).

C. Adding paragraph (h).

D. Revising the authority citation.

The revisions and addition read as follows:

§668.175 Alternative standards and requirements.

* * * * *

(d) Zone alternative. (1) A participating institution that is not financially responsible solely because the Secretary determines that its composite score 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, and to otherwise comply with the provisions, 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 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; or

(B) 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 in paragraph (d)(2)(ii) of this section for which the institution is required to provide information, in accordance with procedures established by the Secretary, 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 paragraphs (d)(2) or (3) of this section, the Secretary may determine that the institution no longer qualifies under this alternative.

(e) [Reserved]

(f) <u>Provisional certification alternative</u>. (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)(1), is subject to an action or triggering event under §668.171(c), or because of an audit opinion described in §668.171(f); 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.

(2) Under this alternative, the institution must--

(i) Provide to the Secretary an irrevocable letter of credit that is acceptable and payable to the Secretary, provide cash, or agree to a set-aside under paragraph (h) of this section, for an amount determined by the Secretary under paragraph (f)(4) of this section, except that this requirement does not apply to a public institution; and

(ii) Comply with the provisions under the zone alternative, as provided under paragraph (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 protection 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.

(4) The institution must provide to the Secretary an irrevocable letter of credit for an amount that is--

(i) For a State or Federal action under §668.171(c)(1)(i)(A) or (B), 10 percent or more, as determined by the Secretary, of the amount of Direct Loan Program funds received by the institution during its most recently completed fiscal year;

(ii) For repayments to the Secretary for losses from borrower defense claims under §668.171(c)(2), equal to the greatest annual loss incurred by the Secretary during the three most recently completed award years to resolve those claims or the amount of losses incurred by the Secretary during the current award year, whichever is greater, plus a portion of the amount of any outstanding or pending claims based on the ratio of the total value of claims resolved in favor of borrowers during the three most recently completed award years to the total value of claims resolved during the three most recently completed award years; and

(iii) For any other action or triggering event described in §668.171(c), or if the institution's composite score is less than 1.0 or the institution no longer qualifies under the zone alternative, 10 percent or more, as determined by the Secretary, of the total amount of title IV, HEA program funds received by the institution during its most recently completed fiscal year.

* * * * *

(h) Set-aside. If an institution does not provide cash or the letter of credit for the amount required under paragraph (d) or (f) of this section within 30 days of the Secretary's request, the Secretary offsets the amount of title IV, HEA program funds that an institution has earned in a manner that ensures that, by the end of a nine-month period, the total amount offset equals the amount of cash or the letter of credit the institution would otherwise provide. The Secretary maintains the amount of funds offset in a temporary escrow account, uses the funds to satisfy the debt and liabilities owed to the Secretary not otherwise paid directly by the institution, and provides to the institution any funds not used for this purpose during the period for which the cash or letter of credit was required.

(Authority: 20 U.S.C. 1094 and 1099c)

11. Section 668.176 is added to subpart L to read as follows:

§668.176 Severability.

If any provision of this subpart or its application to any person, act, or practice is held invalid, the remainder of the subpart or the application of its provisions to any person, act, or practice shall not be affected thereby.

(Authority: 20 U.S.C. 1094, 1099c)

PART 674--FEDERAL PERKINS LOAN PROGRAM

12. The authority citation for part 674 continues to read as follows:

AUTHORITY: 20 U.S.C. 1070g, 1087aa—1087hh, unless otherwise noted.

13. Section 674.33 is amended by:

A. In paragraph (g)(3) introductory text, removing the words "may discharge" and adding, in their place, the word "discharges".

B. In paragraph (g)(3)(i), removing the word "or".

C. In paragraph (g)(3)(ii), removing the period and adding, in its place, the punctuation and word "; or".

D. Adding paragraph (g)(3)(iii).

E. Redesignating paragraphs (g)(8)(vi), (vii), (viii), and (ix) as paragraphs (g)(8)(vii), (viii), (ix), and (x), respectively.

F. Adding a new paragraph (g)(8)(vi).

The additions read as follows:

§674.33 Repayment.

* * * * *

(g) * * *

(3) * * *

(iii) Based on information in the Secretary's possession, the borrower did not subsequently re-enroll in any title IV-eligible institution within a period of three years from the date the school closed.

* * * * *

(8) * * *

(vi) Upon resuming collection on any affected loan, the Secretary provides the borrower another discharge application and an explanation of the requirements and procedures for obtaining a discharge.

* * * * *

14. Section 674.61 is amended by revising paragraph (a) to read as follows:

§674.61 Discharge for death or disability.

(a) Death. (1) An institution must discharge the unpaid balance of a borrower's Defense, NDSL, or Federal Perkins loan, including interest, if the borrower dies. The institution must discharge the loan on the basis of--

(i) An original or certified copy of the death certificate;

(ii) An accurate and complete photocopy of the original or certified copy of the death certificate;

(iii) An accurate and complete original or certified copy of the death certificate that is scanned and submitted electronically or sent by facsimile transmission; or

(iv) Verification of the borrower's death through an authoritative Federal or State electronic database approved for use by the Secretary.

(2) Under exceptional circumstances and on a case-by-case basis, the chief financial officer of the institution may approve a discharge based upon other reliable documentation of the borrower's death.

* * * * *

PART 682--FEDERAL FAMILY EDUCATION LOAN (FFEL) PROGRAM

15. 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]

16. Section 682.202 is amended in paragraph (b)(1) by removing the words “A lender” and adding, in their place, “Except as provided in §682.405(b)(4), a lender”.

17. Section 682.211 is amended by adding paragraph (i)(7) to read as follows:

§682.211 Forbearance.

* * * * *

(i) * * *

(7) The lender must grant a mandatory administrative forbearance to a borrower upon being notified by the Secretary that the borrower has made a borrower defense claim related to a loan that the borrower intends to consolidate into the Direct Loan Program for the purpose of seeking relief in accordance with §685.212(k). The mandatory administrative forbearance shall remain in effect until the lender is notified by the Secretary that the Secretary has made a determination as to the borrower's eligibility for a borrower defense discharge.

* * * * *

18. Section 682.402 is amended by:

A. Revising paragraphs (b)(2), (d)(6)(ii)(F) introductory text and (d)(6)(ii)(H).

B. Redesignating paragraph (d)(6)(ii)(I) as paragraph (d)(6)(ii)(J).

C. Adding new paragraphs (d)(6)(ii)(I) and (d)(6)(ii)(K).

D. In paragraph (d)(8) introductory text, removing the words "may be" and adding in their place the word "is".

E. In paragraph (d)(8)(i), removing the word "or".

F. In paragraph (d)(8)(ii), removing the period and adding in its place the punctuation and word "; or".

G. Adding paragraph (d)(8)(iii).

H. In paragraph (e)(6)(iii), removing the last sentence.

The revisions and additions read as follows:

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

* * * * *

(b) * * *

(2)(i) A discharge of a loan based on the death of the borrower (or student in the case of a PLUS loan) must be based on--

(A) An original or certified copy of the death certificate;

(B) An accurate and complete photocopy of the original or certified copy of the death certificate;

(C) An accurate and complete original or certified copy of the death certificate that is scanned and submitted electronically or sent by facsimile transmission; or

(D) Verification of the borrower's or student's death through an authoritative Federal or State electronic database approved for use by the Secretary.

(ii) Under exceptional circumstances and on a case-by-case basis, the chief executive officer of the guaranty agency may approve a discharge based upon other reliable documentation of the borrower's or student's death.

* * * * *

(d) * * *

(6) * * *

(ii) * * *

(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 shall notify the borrower in writing of that determination, the opportunity for review by the Secretary, and an explanation of the manner in which to request such a review within 30 days after the date the agency--

* * * * *

(H) If a borrower described in paragraph (d)(6)(ii)(E) or (F) fails to submit the completed application within 60 days of being notified of that option, the lender or guaranty agency shall resume collection and shall be deemed to have exercised forbearance of payment of principal and interest from the date it suspended collection activity. The lender may capitalize, in accordance with §682.202(b), any interest accrued and not paid during that period.

(I) Upon resuming collection on any affected loan, the lender or guaranty agency provides the borrower another discharge application and an explanation of the requirements and procedures for obtaining a discharge.

* * * * *

(K)(1) Within 30 days after receiving the borrower’s request for review under paragraph (d)(6)(ii)(F) of this section, the agency shall forward the borrower’s discharge request and all relevant documentation to the Secretary for review.

(2) The Secretary notifies the agency and the borrower of the determination upon review. If the Secretary determines that the borrower is not eligible for a discharge under paragraph (d) of this section, within 30 days after being so informed, the agency shall take the actions described in paragraph (d)(6)(ii)(H) or (d)(6)(ii)(I) 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 shall, within 30 days after being so informed, take actions required under paragraph (d)(6) and (d)(7) of this section, as applicable.

* * * * *

(8) * * *

(iii) The Secretary or guaranty agency determines, based on information in their possession, that the borrower did not subsequently re-enroll in any title IV-eligible institution within a period of three years after the school closed.

* * * * *

19. Section 682.405 is amended by:

A. Redesignating paragraph (b)(4) as paragraph (b)(4)(i).

B. Adding a new paragraph (b)(4)(ii).

The addition reads as follows:

§682.405 Loan rehabilitation agreement.

* * * * *

(b) * * *

(4) * * *

(ii) The lender must not consider the purchase of a rehabilitated loan as entry into repayment or resumption of repayment for the purposes of interest capitalization under §682.202(b).

* * * * *

§682.410 [Amended]

20. Section 682.410 is amended in paragraph (b)(4) by adding, after the words "to the lender", the words and

punctuation ", but shall not capitalize any unpaid interest thereafter".

PART 685--WILLIAM D. FORD FEDERAL DIRECT LOAN PROGRAM

21. The authority citation for part 685 continues to read as follows:

AUTHORITY: 20 U.S.C. 1070g, 1087a, et seq., unless otherwise noted.

22. Section 685.200 is amended by:

A. Adding paragraph (f)(3)(v).

B. Adding paragraph (f)(4)(iii).

The additions 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 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, 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 defense to repayment 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 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.

* * * * *

23. Section 685.205 is amended by revising paragraph (b)(6) to read as follows:

§685.205 Forbearance.

* * * * *

(b) * * *

(6) Periods necessary for the Secretary to determine the borrower's eligibility for discharge--

(i) Under §685.206(c);

(ii) Under §685.214;

(iii) Under §685.215;

(iv) Under §685.216;

(v) Under §685.217;

(vi) Under §685.222; or

(vii) Due to the borrower's or endorser's (if applicable) bankruptcy;

* * * * *

24. Section 685.206 is amended by revising paragraph (c) to read as follows:

<u>§685.206 Borrower responsibilities and defenses</u>.

* * * * *

(c) <u>Borrower defenses</u>. (1) For loans first disbursed prior to July 1, 2017, the borrower may assert a borrower defense under this paragraph (c). A "borrower defense" refers to any act or omission of the school attended by the student that relates to the making of the loan or the provision of educational services for which the loan was provided that would give rise to a cause of action against the school under applicable State law, and includes one or both of the following:

(i) A defense to repayment of amounts owed to the Secretary on a Direct Loan, in whole or in part.

(ii) A claim to recover amounts previously collected by the Secretary on the Direct Loan, in whole or in part.

(2) The order of objections for defaulted Direct Loans are as described in §685.222(a)(1) to (6). A borrower defense claim under this section must be asserted, and will be resolved, under the procedures in §685.222(e) to (k).

(3) For an approved borrower defense under this section, the Secretary may initiate an appropriate proceeding to collect from the school whose act or omission resulted in the borrower defense the amount of relief arising from the borrower defense.

* * * * *

<u>§685.209 [Amended]</u>

25. Section 685.209 is amended by:

A. In paragraph (a)(1)(ii), adding the punctuation and words ", for purposes of determining whether a borrower has a partial financial hardship in accordance with paragraph (a)(1)(v) of this section or adjusting a borrower's monthly payment amount in accordance with paragraph (a)(2)(ii) of this section," immediately after the words "Eligible loan".

B. In paragraph (c)(1)(ii), adding the punctuation and words ", for purposes of adjusting a borrower's monthly payment amount in accordance with paragraph (c)(2)(ii) of this section," immediately after the words "Eligible loan".

C. In paragraph (c)(2)(ii)(B) introductory text, removing the word "Both" and adding, in its place, the words "Except in the case of a married borrower filing separately whose spouse's income is excluded in accordance with paragraph (c)(1)(i)(A) or (B) of this section, both".

D. In paragraph (c)(2)(v), removing the words "or the Secretary determines the borrower does not have a partial financial hardship".

E. In paragraph (c)(4)(iii)(B), removing the citations "(c)(2)(iv), (c)(4)(v), and (c)(4)(vi)" and adding, in their place, the citations "(c)(2)(iv) and (c)(4)(v)".

26. Section 685.212 is amended by:

A. Revising paragraphs (a)(1) and (a)(2).

B. Adding paragraph (k).

The revision and addition read as follows:

<u>§685.212 Discharge of a loan obligation</u>.

(a) <u>Death</u>. (1) If a borrower (or a student on whose behalf a parent borrowed a Direct PLUS Loan) dies, the Secretary discharges the obligation of the borrower and any endorser to make any further payments on the loan based on--

(i) An original or certified copy of the death certificate;

(ii) An accurate and complete photocopy of the original or certified copy of the death certificate;

(iii) An accurate and complete original or certified copy of the death certificate that is scanned and submitted electronically or sent by facsimile transmission; or

(iv) Verification of the borrower's or student's death through an authoritative Federal or State electronic database approved for use by the Secretary.

(2) Under exceptional circumstances and on a case-by-case basis, the Secretary discharges a loan based upon other reliable documentation of the borrower's or student's death that is acceptable to the Secretary.

* * * * *

(k) <u>Borrower defenses</u>. (1) If a borrower defense is approved under §685.206(c) or §685.222--

(i) The Secretary discharges the obligation of the borrower in whole or in part in accordance with the procedures in §§685.206(c) and 685.222, respectively; and

(ii) The Secretary returns to the borrower payments made by the borrower or otherwise recovered on the loan that exceed the amount owed on that portion of the loan not discharged, if the borrower asserted the claim not later than--

(A) For a claim subject to §685.206(c), the limitation period under applicable law to the claim on which relief was granted; or

(B) For a claim subject to §685.222, the limitation period in §685.222(b), (c), or (d), as applicable.

(2) In the case of a Direct Consolidation Loan, a borrower may assert a borrower defense under §685.206(c) or §685.222 with respect to a Direct Loan, a FFEL Program Loan, a Federal Perkins Loan, Health Professions Student Loan, Loan for Disadvantaged Students under subpart II of part A of title VII of the Public Health Service Act, Health Education Assistance Loan, or Nursing Loan made under subpart II of part B of the Public Health Service Act that was repaid by the Direct Consolidation Loan.

(i) The Secretary considers a borrower defense claim asserted on a Direct Consolidation Loan by determining --

(A) Whether the act or omission of the school with regard to the loan described in paragraph (k)(2) of this section other than a Direct Subsidized, Unsubsidized, or PLUS Loan, constitutes a borrower defense under §685.206(c), for a Direct Consolidation Loan made before

July 1, 2017, or under §685.222, for a Direct Consolidation Loan made on or after July 1, 2017; or

(B) Whether the act or omission of the school with regard to a Direct Subsidized, Unsubsidized, or PLUS Loan made on after July 1, 2017 that was paid off by the Direct Consolidation Loan, constitutes a borrower defense under §685.222.

(ii) If the borrower defense is approved, the Secretary discharges the appropriate portion of the Direct Consolidation Loan.

(iii) The Secretary returns to the borrower payments made by the borrower or otherwise recovered on the Direct Consolidation Loan that exceed the amount owed on that portion of the Direct Consolidation Loan not discharged, if the borrower asserted the claim not later than--

(A) For a claim asserted under §685.206(c), the limitation period under applicable law to the claim on which relief was granted; or

(B) For a claim asserted under §685.222, the limitation period in §685.222(b), (c), or (d), as applicable.

(iv) The Secretary returns to the borrower a payment made by the borrower or otherwise recovered on the loan described in paragraph (k)(2) of this section only if--

(A) The payment was made directly to the Secretary on the loan; and

(B) The borrower proves that the loan to which the payment was credited was not legally enforceable under applicable law in the amount for which that payment was applied.

* * * * *

27. Section 685.214 is amended by:

A. Revising paragraph (c)(2).

B. Revising paragraph (f)(4).

C. Redesignating paragraphs (f)(5) and (6) as paragraphs (f)(6) and (7), respectively.

D. Adding a new paragraph (f)(5).

The revisions and addition read as follows:

§685.214 Closed school discharge.

* * * * *

(c) * * *

(2) The Secretary discharges a loan under this section without an application from the borrower if the Secretary determines, based on information in the Secretary's possession, that--

(i) The borrower qualifies for the discharge; and

(ii) The borrower did not subsequently re-enroll in any title IV-eligible institution within a period of three years from the date the school closed.

* * * * *

(f) * * *

(4) If a borrower fails to submit the application described in paragraph (c) of this section within 60 days of the Secretary's providing the discharge application, 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.

(5) Upon resuming collection on any affected loan, the Secretary provides the borrower another discharge application and an explanation of the requirements and procedures for obtaining a discharge.

* * * * *

28. Section 685.215 is amended by:

A. Revising paragraph (a)(1).

B. Revising paragraph (c) introductory text.

C. Revising paragraph (c)(1).

D. Redesignating paragraphs (c)(2) through (7) as paragraphs (c)(3) through (8), respectively.

E. Adding a new paragraph (c)(2).

F. Revising redesignated paragraph (c)(8).

G. Revising paragraph (d).

The revisions and addition read as follows:

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

(a) Basis for discharge — (1) False certification. The Secretary discharges a borrower's (and any endorser's) obligation to repay a Direct Loan in accordance with the provisions of this section if a school falsely certifies the eligibility of the borrower (or the student on whose behalf a parent borrowed) to receive the proceeds of a Direct Loan. The Secretary considers a student's eligibility to borrow to have been falsely certified by the school if the school--

(i) Certified the eligibility of a student who

(A) Reported not having a high school diploma or its equivalent; and

(B) Did not satisfy the alternative to graduation from high school requirements under section 484(d) of the Act that were in effect at the time of certification;

(ii) Certified the eligibility of a student who is not a high school graduate based on--

(A) A high school graduation status falsified by the school; or

(B) A high school diploma falsified by the school or a third party to which the school referred the borrower;

(iii) Signed the borrower's name on the loan application or promissory note without the borrower's authorization;

(iv) 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 State requirements for employment (in the student's State of residence when the loan was originated) in the occupation for which the training program supported by the loan was intended; or

(v) Certified the eligibility of a student for a Direct Loan as a result of the crime of identity theft committed against the individual, as that crime is defined in paragraph (c)(5)(ii) of this section.

* * * * *

(c) <u>Borrower qualification for discharge</u>. 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. The application need not be notarized but must be made by the borrower under penalty of perjury; and in the application, the borrower’s responses must demonstrate to the satisfaction of the Secretary that the requirements in paragraph (c)(1) through (7) of this section have been met. If the Secretary determines the application does not meet the requirements, the Secretary notifies the applicant and explains why the application does not meet the requirements.

(1) High school diploma or equivalent. In the case of a borrower requesting a discharge based on not having had a high school diploma and not having met the alternative to graduation from high school eligibility requirements under section 484(d) of the Act applicable at the time the loan was originated, and the school or a third party to which the school referred the borrower falsified the student's high school diploma, the borrower must state in the application that that the borrower (or the student on whose behalf a parent received a PLUS loan)--

(i) Did not have a valid high school diploma at the time the loan was certified; and

(ii) Did not satisfy the alternative to graduation from high school statutory or regulatory eligibility requirements identified on the application form and applicable at the time the institution certified the loan.

(2) Disqualifying condition. In the case of a borrower requesting a discharge based on a condition that would disqualify the borrower from employment in the

occupation that the training program for which the borrower received the loan was intended, the borrower must state in the application that the borrower (or student for whom a parent received a PLUS loan) did not meet State requirements for employment (in the student's State of residence) in the occupation that the training program for which the borrower received the loan was intended because of a physical or mental condition, age, criminal record, or other reason accepted by the Secretary.

* * * * *

(8) Discharge without an application. The Secretary discharges all or part of a loan as appropriate under this section without an application from the borrower if the Secretary determines, based on information in the Secretary's possession, that the borrower qualifies for a discharge. Such information includes, but is not limited to, evidence that the school has falsified the Satisfactory Academic Progress of its students, as described in §668.34.

(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 an application and an explanation of 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 the application described in paragraph (c) of this section within 60 days of the Secretary's providing the application, 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 the application described in paragraph (c) of this section, the Secretary determines whether the available evidence supports the claim for discharge. Available evidence includes evidence provided by the borrower and any other relevant information from the Secretary’s records and gathered by the Secretary from other sources, including guaranty agencies, State authorities, test publishers, independent test administrators, school records, and cognizant accrediting associations. The Secretary issues a decision that explains the reasons for any adverse determination on the application, describes the evidence on which the decision was made, and provides the borrower, upon request, copies of the evidence, and considers any response from the borrower and any additional information from the borrower,

and notifies the borrower whether the determination is changed.

(4) If the Secretary determines that the borrower meets the applicable requirements for a discharge under paragraph (c) of this section, the Secretary notifies the borrower in writing of that determination.

(5) If the Secretary determines that the borrower does not qualify for a discharge, the Secretary notifies the borrower in writing of that determination and the reasons for the determination.

* * * * *

§685.220 [Amended]

29. Section 685.220 is amended by:

A. Removing the words "subpart II of part B" from paragraph (b)(21) and adding, in their place, the words "part E".

B. Removing paragraph (d)(1)(i).

C. Redesignating paragraph (d)(1)(ii) as (d)(1)(i), and paragraph (d)(1)(iii) as (d)(1)(ii).

30. Section 685.222 is added to subpart B to read as follows:

§685.222 Borrower defenses.

(a) General. (1) For loans first disbursed prior to July 1, 2017, a borrower asserts and the Secretary considers a borrower defense in accordance with the provisions of §685.206(c), unless otherwise noted in §685.206(c).

(2) For loans first disbursed on or after July 1, 2017, a borrower asserts and the Secretary considers a borrower defense in accordance with this section. To establish a borrower defense under this section, a preponderance of the evidence must show that the borrower has a borrower defense that meets the requirements of this section.

(3) A violation by the school of an eligibility or compliance requirement in the Act or its implementing regulations is not a basis for a borrower defense under either this section or §685.206(c) unless the violation would otherwise constitute a basis for a borrower defense under this section.

(4) For the purposes of this section or §685.206(c), "borrower" means--

(i) The borrower; and

(ii) In the case of a Direct PLUS Loan, the student and any endorsers.

(5) For the purposes of this section or §685.206(c), a "borrower defense" refers to an act or omission of the school attended by the student that relates to the making

of a Direct Loan for enrollment at the school or the provision of educational services for which the loan was provided and that meets the requirements under paragraphs (b), (c), or (d), and includes one or both of the following:

(i) A defense to repayment of amounts owed to the Secretary on a Direct Loan, in whole or in part; and

(ii) A right to recover amounts previously collected by the Secretary on the Direct Loan, in whole or in part.

(6) If the borrower asserts both a borrower defense and any other objection to an action of the Secretary with regard to that Direct Loan, the Secretary notifies the borrower of the order in which the Secretary considers the borrower defense and any other objections. The order in which the Secretary will consider objections, including a borrower defense, will be determined by the Secretary as appropriate under the circumstances.

(b) Judgment against the school. (1) The borrower has a borrower defense if the borrower, whether as an individual or as a member of a class, or a governmental agency, has obtained against the school a nondefault, favorable contested judgment based on State or Federal law in a court or administrative tribunal of competent jurisdiction.

(2) A borrower may assert a borrower defense under this paragraph at any time.

(c) Breach of contract by the school. The borrower has a borrower defense if the school the borrower received a Direct Loan to attend failed to perform its obligations under the terms of a contract with the student. A borrower may assert a defense to repayment of amounts owed to the Secretary under this paragraph at any time after the breach by the school of its contract with the student. A borrower may assert a right to recover amounts previously collected by the Secretary under this paragraph not later than six years after the breach by the school of its contract with the student.

(d) Substantial misrepresentation by the school. (1) A borrower has a borrower defense if the school or any of its representatives, or any institution, organization, or person with whom the school has an agreement to provide educational programs, or to provide marketing, advertising, recruiting, or admissions services, made a substantial misrepresentation in accordance with 34 CFR part 668, subpart F, that the borrower reasonably relied on when the borrower decided to attend, or to continue attending, the school. A borrower may assert, at any time, a defense to repayment under this paragraph (d) of amounts owed to the

Secretary. A borrower may assert a claim under this paragraph (d) to recover funds previously collected by the Secretary not later than six years after the borrower discovers, or reasonably could have discovered, the information constituting the substantial misrepresentation.

(2) For the purposes of this section, a designated Department official pursuant to paragraph (e) of this section or a hearing official pursuant to paragraphs (f), (g), or (h) may consider, as evidence supporting the reasonableness of a borrower's reliance on a misrepresentation, whether the school or any of the other parties described in paragraph (d)(1) engaged in conduct such as, but not limited to:

(i) Demanding that the borrower make enrollment or loan-related decisions immediately;

(ii) Placing an unreasonable emphasis on unfavorable consequences of delay;

(iii) Discouraging the borrower from consulting an adviser, a family member, or other resource;

(iv) Failing to respond to the borrower's requests for more information, including about the cost of the program and the nature of any financial aid; or

(v) Otherwise unreasonably pressuring the borrower or taking advantage of the borrower’s distress or lack of knowledge or sophistication.

(e) <u>Procedure for an individual borrower</u>. (1) To assert a borrower defense under this section, an individual borrower must--

(i) Submit an application to the Secretary, on a form approved by the Secretary--

(A) Certifying that the borrower received the proceeds of a loan, in whole or in part, to attend a named school;

(B) Providing evidence that supports the borrower defense; and

(C) Indicating whether the borrower has made a claim with respect to the information underlying the borrower defense 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 credited to the borrower's loan obligation; and

(ii) Provide any other information or supporting documentation reasonably requested by the Secretary.

(2) Upon receipt of a borrower’s application, the Secretary--

(i) If the borrower is not in default on the loan for which a borrower defense has been asserted, grants forbearance and--

(A) Notifies the borrower of the option to decline the forbearance and to continue making payments on the loan; and

(B) Provides the borrower with information about the availability of the income-contingent repayment plans under §685.209 and the income-based repayment plan under §685.221; or

(ii) If the borrower is in default on the loan for which a borrower defense has been asserted--

(A) Suspends collection activity on the loan until the Secretary issues a decision on the borrower's claim;

(B) Notifies the borrower of the suspension of collection activity and explains that collection activity will resume if the Secretary determines that the borrower does not qualify for a full discharge; and

(C) Notifies the borrower of the option to continue making payments under a rehabilitation agreement or other repayment agreement on the defaulted loan.

(3) The Secretary designates a Department official to review the borrower's application to determine whether the application states a basis for a borrower defense, and

resolves the claim through a fact-finding process conducted by the Department official.

(i) As part of the fact-finding process, the Department official notifies the school of the borrower defense and considers any evidence or argument presented by the borrower and also any additional information, including--

(A) Department records;

(B) Any response or submissions from the school; and

(C) Any additional information or argument that may be obtained by the Department official.

(ii) The Department official identifies to the borrower and may identify to the school the records he or she considers relevant to the borrower defense. The Secretary provides to the borrower or the school any of the identified records upon reasonable request.

(4) At the conclusion of the fact-finding process, the Department official issues a written decision as follows:

(i) If the Department official approves the borrower defense in full or in part, the Department official notifies the borrower in writing of that determination and of the relief provided as described in paragraph (i) of this section.

(ii) If the Department official denies the borrower defense in full or in part, the Department official notifies the borrower of the reasons for the denial, the evidence that was relied upon, any portion of the loan that is due and payable to the Secretary, and whether the Secretary will reimburse any amounts previously collected, and informs the borrower that if any balance remains on the loan, the loan will return to its status prior to the borrower's submission of the application. The Department official also informs the borrower of the opportunity to request reconsideration of the claim based on new evidence pursuant to paragraph (e)(5)(i) of this section.

(5) The decision of the Department official is final as to the merits of the claim and any relief that may be granted on the claim. Notwithstanding the foregoing--

(i) If the borrower defense is denied in full or in part, the borrower may request that the Secretary reconsider the borrower defense upon the identification of new evidence in support of the borrower's claim. "New evidence" is relevant evidence that the borrower did not previously provide and that was not identified in the final decision as evidence that was relied upon for the final decision; and

(ii) The Secretary may reopen a borrower defense application at any time to consider evidence that was not considered in making the previous decision.

(6) The Secretary may consolidate applications filed under this paragraph (e) that have common facts and claims, and resolve the borrowers' borrower defense claims as provided in paragraphs (f), (g), and (h) of this section.

(7) The Secretary may initiate a separate proceeding to collect from the school the amount of relief resulting from a borrower defense under this paragraph.

(f) Group process for borrower defense, generally. (1) 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 participants, the Secretary may initiate a process to determine whether a group of borrowers, identified by the Secretary, has a borrower defense.

(i) The members of the group may be identified by the Secretary from individually filed applications pursuant to paragraph (e)(6) of this section or from any other source.

(ii) If the Secretary determines that there are common facts and claims that apply to borrowers who have not filed an application under paragraph (e) of this section, the Secretary may identify such borrowers as members of a group.

(2) Upon the identification of a group of borrowers under paragraph (f)(1) of this section, the Secretary--

(i) Designates a Department official to present the group's claim in the fact-finding process described in paragraph (g) or (h) of this section, as applicable;

(ii) Provides each identified member of the group with notice that allows the borrower to opt out of the proceeding; and

(iii) Notifies the school, as practicable, of the basis of the group's borrower defense, the initiation of the fact-finding process described in paragraph (g) or (h) of this section, and of any procedure by which to request records and respond.

(3) For a group of borrowers identified by the Secretary, for which the Secretary determines that there may be a borrower defense under paragraph (d) based upon a substantial misrepresentation that has been widely disseminated, there is a rebuttable presumption that each member reasonably relied on the misrepresentation.

(g) Procedures for group process for borrower defenses with respect to loans made to attend a closed school. For groups identified by the Secretary under paragraph (f) of this section, for which the borrower defense is asserted with respect to a Direct Loan to attend a school that has closed and has provided no financial protection currently available to the Secretary from which to recover any losses arising from borrower defenses, and for which there is no appropriate entity from which the Secretary can otherwise practicably recover such losses--

(1) A hearing official resolves the borrower defense through a fact-finding process. As part of the fact-finding process, the hearing official considers any evidence and argument presented by the Department official on behalf of the group and, as necessary to determine any claims at issue, on behalf of individual members of the group. The hearing official also considers any additional information the Department official considers necessary, including any Department records or response from the school or a person affiliated with the school as described in §668.174(b), if practicable. The hearing official issues a written decision as follows:

(i) If the hearing official approves the borrower defense in full or in part, the written decision notifies the members of the group in writing of that determination and of the relief provided on the basis of that claim as determined under paragraph (i) of this section.

(ii) If the hearing official denies the borrower defense in full or in part, the written decision states the reasons for the denial, the evidence that was relied upon, the portion of the loans that are due and payable to the Secretary, and whether reimbursement of amounts previously collected is granted, and informs the borrowers that if any balance remains on the loan, the loan will return to its status prior to the group claim process.

(iii) The Secretary provides copies of the written decision to the members of the group and, as practicable, to the school.

(2) The decision of the hearing official is final as to the merits of the group borrower defense and any relief that may be granted on the group claim.

(3) After a final decision has been issued, if relief for the group has been denied in full or in part pursuant to paragraph (g)(1)(ii) of this section, an individual borrower may file a claim for relief pursuant to paragraph (e)(5)(i) of this section.

(4) The Secretary may reopen a borrower defense application at any time to consider evidence that was not considered in making the previous decision.

(h) <u>Procedures for group process for borrower defenses with respect to loans made to attend an open</u>

school. For groups identified by the Secretary under paragraph (f) of this section, for which the borrower defense is asserted with respect to Direct Loans to attend an open school or a school that is not otherwise covered by paragraph (g) of this section, the claim is resolved in accordance with the procedures in this paragraph (h).

(1) A hearing official resolves the borrower defense and determines any liability of the school through a fact-finding process. As part of the process, the hearing official considers any evidence and argument presented by the school and the Department official on behalf of the group and, as necessary to determine any claims at issue, on behalf of individual members of the group. The hearing official issues a written decision as follows:

(i) If the hearing official approves the borrower defense in full or in part, the written decision establishes the basis for the determination, notifies the members of the group of the relief as described in paragraph (i) of this section, and notifies the school of any liability to the Secretary for the amounts discharged and reimbursed.

(ii) If the hearing official denies the borrower defense for the group in full or in part, the written decision states the reasons for the denial, the evidence that was relied upon, the portion of the loans that are due and payable to the Secretary, and whether reimbursement of amounts previously collected is granted, and informs the borrowers that their loans will return to their statuses prior to the group borrower defense process. The decision notifies the school of any liability to the Secretary for any amounts discharged or reimbursed.

(iii) The Secretary provides copies of the written decision to the members of the group, the Department official, and the school.

(2) The decision of the hearing official becomes final as to the merits of the group borrower defense and any relief that may be granted on the group borrower defense within 30 days after the decision is issued and received by the Department official and the school unless, within that 30-day period, the school or the Department official appeals the decision to the Secretary. In the case of an appeal--

(i) The decision of the hearing official does not take effect pending the appeal; and

(ii) The Secretary renders a final decision.

(3) After a final decision has been issued, if relief for the group has been denied in full or in part pursuant to paragraph (h)(1)(ii) of this section, an individual

borrower may file a claim for relief pursuant to paragraph (e)(5)(i) of this section.

(4) The Secretary may reopen a borrower defense application at any time to consider evidence that was not considered in making the previous decision.

(5) The Secretary collects from the school any liability to the Secretary for any amounts discharged or reimbursed to borrowers under this paragraph (h).

(i) Relief. If a borrower defense is approved under the procedures in paragraphs (e), (g), or (h) of this section--

(1) The Department official or the hearing official, as applicable, determines the appropriate method for calculating, and the amount of, relief arising out of the facts underlying an individual or group borrower defense, based on information then available to the official or which the official may request; and determines the amount of relief to award the borrower, which may be a discharge of all amounts owed to the Secretary on the loan at issue and may include the recovery of amounts previously collected by the Secretary on the loan, or some lesser amount. In determining the appropriate method for calculating relief, the Department official or the hearing official, as applicable--

(i) Will consider the availability of information required for a method of calculation;

(ii) When calculating relief for a group of borrowers, may consider information derived from a sample of borrowers from the group; and

(iii) May use one or more of the methods described in Appendix A to this subpart, or such other method determined by the official;

(2) In the written decision described in paragraphs (e), (g), and (h) of this section, the designated Department official or hearing official, as applicable, notifies the borrower of the relief provided and--

(i) Specifies the relief determination;

(ii) Advises that there may be tax implications; and

(iii) Provides the borrower an opportunity to opt out of group relief, if applicable;

(3) Consistent with the determination of relief under paragraph (i)(1) of this section, the Secretary discharges the borrower's obligation to repay all or part of the loan and associated costs and fees that the borrower would otherwise be obligated to pay and, if applicable, reimburses the borrower for amounts paid toward the loan voluntarily or through enforced collection;

(4) The Secretary or the hearing official, as applicable, affords the borrower such further relief as the Secretary or the hearing official determines is appropriate under the circumstances. Such further relief includes, but is not limited to, one or both of the following:

(i) Determining that the borrower is not in default on the loan and is eligible to receive assistance under title IV of the Act.

(ii) Updating reports to consumer reporting agencies to which the Secretary previously made adverse credit reports with regard to the borrower's Direct Loan; and

(5) The total amount of relief granted with respect to a borrower defense cannot exceed the amount of the loan and any associated costs and fees and will be reduced by the amount of any refund, reimbursement, indemnification, restitution, compensatory damages, settlement, debt forgiveness, discharge, cancellation, compromise, or any other benefit received by, or on behalf of, the borrower that was related to the borrower defense. The relief to the borrower may not include non-pecuniary damages such as inconvenience, aggravation, emotional distress, or punitive damages.

(j) Cooperation by the borrower. To obtain relief under this section, a borrower must reasonably cooperate with the Secretary in any proceeding under paragraph (e), (g), or (h) of this section. The Secretary may revoke any relief granted to a borrower who fails to satisfy his or her obligations under this paragraph (j).

(k) <u>Transfer to the Secretary of the borrower's right of recovery against third parties</u>. (1) Upon the granting of any relief under 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 contract for educational services for which the loan was received, against the school, its principals, its affiliates, and their successors, its sureties, and any private fund. 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.

(2) The provisions of this paragraph (k) 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.

(3) Nothing in this paragraph (k) limits or forecloses the borrower's right to pursue legal and equitable relief against a party described in this paragraph (k) 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.

31. Section 685.223 is added to subpart B to read as follows:

§685.223 Severability.

If any provision of this subpart or its application to any person, act, or practice is held invalid, the remainder of the subpart or the application of its provisions to any person, act, or practice shall not be affected thereby.

(Authority: 20 U.S.C. 1087a et seq.)

32. Appendix A to subpart B of part 685 is added to read as follows:

Appendix A to Subpart B of Part 685--Calculating Borrower Relief

The Department official or the hearing official, as applicable, determines the amount of relief to award the borrower, which may be a discharge of all amounts owed to the Secretary on the loan at issue and may include the recovery of amounts previously collected by the Secretary on the loan, or some lesser amount. A borrower's relief may be calculated using one or more of the following methods or such other method as the Secretary may determine.

(A) The difference between what the borrower paid, and what a reasonable borrower would have paid had the school made an accurate representation as to the issue that was the subject of the substantial misrepresentation underlying the borrower defense claim.

(B) The difference between the amount of financial charges the borrower could have reasonably believed the school was charging, and the actual amount of financial charges made by the school, for claims regarding the cost of a borrower's program of study.

(C) The total amount of the borrower's economic loss, less the value of the benefit, if any, of the education obtained by the student. Economic loss, for the purposes of this section, may be no greater than the cost of attendance. The value of the benefit of the education may include transferable credits obtained and used by the borrower; and for gainful employment programs, qualifying placement in an occupation within the Standard Occupational Classification (SOC) code for which the training was provided, provided the borrower's earnings meet the expected salary for the program's designated occupations or field, as determined using an earnings benchmark for that occupation. The Department official or hearing official will consider any evidence indicating that no identifiable benefit of the education was received by the student.

33. Section 685.300 is amended by:

A. Redesignating paragraph (b)(11) as paragraph (b)(12).

B. Adding a new paragraph (b)(11).

C. Adding new paragraphs (d) through (i).

The additions read as follows:

<u>§685.300 Agreements between an eligible school and the Secretary for participation in the Direct Loan Program</u>.

* * * * *

(b) * * *

(11) Comply with the provisions of paragraphs (d) through (i) regarding student claims and disputes.

* * * * *

(d) <u>Borrower defense claims in an internal dispute process</u>. The school will not compel any student to pursue a complaint based on a borrower defense claim through an internal institutional process before the student presents the complaint to an accrediting agency or government agency authorized to hear the complaint.

(e) <u>Class action bans</u>. (1) The school shall not seek to rely in any way on a pre-dispute arbitration agreement, nor on any other pre-dispute agreement, with a student, with respect to any aspect of a class action that is related to a borrower defense claim including to seek a stay or dismissal of particular claims or the entire action, unless and until the presiding court has ruled that the case may not proceed as a class action and, if that ruling may be subject to appellate review on an interlocutory basis, the time to seek such review has elapsed or the review has been resolved.

(2) Reliance on a pre-dispute arbitration agreement, or on any other pre-dispute agreement, with a student, with respect to any aspect of a class action includes, but is not limited to, any of the following:

(i) Seeking dismissal, deferral, or stay of any aspect of a class action;

(ii) Seeking to exclude a person or persons from a class in a class action;

(iii) Objecting to or seeking a protective order intended to avoid responding to discovery in a class action;

(iv) Filing a claim in arbitration against a student who has filed a claim on the same issue in a class action;

(v) Filing a claim in arbitration against a student who has filed a claim on the same issue in a class action after the trial court has denied a motion to certify the class but before an appellate court has ruled on an interlocutory appeal of that motion, if the time to seek such an appeal has not elapsed or the appeal has not been resolved; and

(vi) Filing a claim in arbitration against a student who has filed a claim on the same issue in a class action after the trial court in that class action has granted a motion to dismiss the claim and, in doing so, the court noted that the consumer has leave to refile the claim on a class basis, if the time to refile the claim has not elapsed.

(3) Required provisions and notices. (i) The school must include the following provision in any agreements with a student recipient of a Direct Loan for attendance at the

school, or, with respect to a Parent PLUS Loan, a student for whom the PLUS loan was obtained, that include any agreement regarding pre-dispute arbitration or any other pre-dispute agreement addressing class actions and that are entered into after effective date of this regulation:

> "We agree that neither we nor anyone else will use this agreement to stop you from being part of a class action lawsuit in court. You may file a class action lawsuit in court or you may be a member of a class action lawsuit even if you do not file it. This provision applies only to class action claims concerning our acts or omissions regarding the making of the Direct Loan or the provision by us of educational services for which the Direct Loan was obtained."

(ii) When a pre-dispute arbitration agreement or any other pre-dispute agreement addressing class actions has been entered into before the effective date of this regulation that did not contain a provision described in paragraph (e)(3)(i) of this section, the school must either ensure the agreement is amended to contain the provision specified in paragraph (e)(3)(iii)(A) of this section or provide the student to whom the agreement applies with the written notice specified in paragraph (e)(3)(iii)(B) of this section.

(iii) The school must ensure the agreement described in paragraph (e)(3)(ii) of this section is amended to contain the provision specified in paragraph (e)(3)(iii)(A) or must provide the notice specified in paragraph (e)(3)(iii)(B) to students no later than the exit counseling required under §685.304(b), or the date on which the school files its initial response to a demand for arbitration or service of a complaint from a student who has not already been sent a notice or amendment.

(A) Agreement provision.

> "We agree that neither we nor anyone else who later becomes a party to this agreement will use it to stop you from being part of a class action lawsuit in court. You may file a class action lawsuit in court or you may be a member of a class action lawsuit even if you do not file it. This provision applies only to class action claims concerning our acts or omissions regarding the making of the Direct Loan or the provision by us of educational services for which the Direct Loan was obtained."

(B) Notice provision.

"We agree not to use any pre-dispute agreement to stop you from being part of a class action lawsuit in court. You may file a class action lawsuit in court or you may be a member of a class action lawsuit even if you do not file it. This provision applies only to class action claims concerning our acts or omissions regarding the making of the Direct Loan or the provision by us of educational services for which the Direct Loan was obtained."

(f) Pre-dispute arbitration agreements. (1) The school will not compel a student to enter into a pre-dispute agreement to arbitrate a borrower defense claim, or rely in any way on a mandatory pre-dispute arbitration agreement with respect to any aspect of a borrower defense claim.

(2) Reliance on a mandatory pre-dispute arbitration agreement with respect to any aspect of a borrower defense claim includes, but is not limited to, any of the following:

(i) Seeking dismissal, deferral, or stay of any aspect of a judicial action filed by the student;

(ii) Objecting to or seeking a protective order intended to avoid responding to discovery in a judicial action filed by the student; and

(iii) Filing a claim in arbitration against a student who has filed a suit on the same claim.

(3) <u>Required provisions and notices</u>. (i) The school must include the following provision in any mandatory pre-dispute arbitration agreements with a student recipient of a Direct Loan for attendance at the school, or, with respect to a Parent PLUS Loan, a student for whom the PLUS loan was obtained, that include any agreement regarding arbitration and that are entered into after effective date of this regulation:

> "We agree that neither we nor anyone else will use this agreement to stop you from bringing a lawsuit regarding our acts or omissions regarding the making of the Direct Loan or the provision by us of educational services for which the Direct Loan was obtained. You may file a lawsuit for such a claim or you may be a member of a class action lawsuit for such a claim even if you do not file it. This provision does not apply to lawsuits concerning other claims."

(ii) When a mandatory pre-dispute arbitration agreement has been entered into before the effective date of this regulation that did not contain a provision described in paragraph (f)(3)(i), the school shall either ensure the agreement is amended to contain the provision specified in paragraph (f)(3)(iii)(A) of this section or provide the student to whom the agreement applies with the written notice specified in paragraph (f)(3)(iii)(B) of this section.

(iii) The school shall ensure the agreement described in paragraph (f)(3)(ii) of this section is amended to contain the provision specified in paragraph (f)(3)(iii)(A) or shall provide the notice specified in paragraph (f)(3)(iii)(B) to students no later than the exit counseling required under §685.304(b), or the date on which the school files its initial response to a demand for arbitration or service of a complaint from a student who has not already been sent a notice or amendment.

(A) Agreement provision.

> "We agree that neither we nor anyone else who later becomes a party to this pre-dispute arbitration agreement will use it to stop you from bringing a lawsuit regarding our acts or omissions regarding the making of the Direct Loan or the provision by us of educational services for which the Direct Loan was obtained. You may file a lawsuit for such a claim or you may be a member of a class action lawsuit for

such a claim even if you do not file it. This provision does not apply to other claims."

(B) Notice provision.

"We agree not to use any pre-dispute arbitration agreement to stop you from bringing a lawsuit regarding our acts or omissions regarding the making of the Direct Loan or the provision by us of educational services for which the Direct Loan was obtained. You may file a lawsuit regarding such a claim or you may be a member of a class action lawsuit regarding such a claim even if you do not file it. This provision does not apply to any other claims."

(g) Submission of arbitral records. (1) A school shall submit a copy of the following records to the Secretary, in the form and manner specified by the Secretary, in connection with any claim filed in arbitration by or against the school concerning a borrower defense claim:

(i) The initial claim and any counterclaim;

(ii) The pre-dispute arbitration agreement filed with the arbitrator or arbitration administrator;

(iii) The judgment or award, if any, issued by the arbitrator or arbitration administrator;

(iv) If an arbitrator or arbitration administrator refuses to administer or dismisses a claim due to the school's failure to pay required filing or administrative fees, any communication the school receives from the arbitrator or an arbitration administrator related to such a refusal; and

(v) Any communication the school receives from an arbitrator or an arbitration administrator related to a determination that a pre-dispute arbitration agreement regarding educational services provided by the school does not comply with the administrator's fairness principles, rules, or similar requirements, if such a determination occurs.

(2) Deadline for submission. A school shall submit any record required pursuant to paragraph (g)(1) of this section within 60 days of filing by the school of any such record with the arbitrator or arbitration administrator and within 60 days of receipt by the school of any such record filed or sent by someone other than the school, such as the arbitration administrator or the student.

(h) Submission of judicial records. (1) A school shall submit a copy of the following records to the Secretary, in the form and manner specified by the Secretary, in connection with any claim filed in a lawsuit by the school against the student, or by any party, including a government agency, against the school concerning a borrower defense claim:

(i) The complaint and any counterclaim;

(ii) Any dispositive motion filed by a party to the suit; and

(iii) The ruling on any dispositive motion and the judgment issued by the court.

(2) Deadline for submission. A school shall submit any record required pursuant to paragraph (h)(1) of this section within 30 days of filing or receipt, as applicable, of the complaint, answer, or dispositive motion, and within 30 days of receipt of any ruling on a dispositive motion or a final judgment.

(i) Definitions. For the purposes of paragraphs (d) through (h) of this section, the term--

(1) "Borrower defense claim" means a claim that is or could be asserted as a defense to repayment under §685.206(c) or §685.222;

(2) "Class action" means a lawsuit in which one or more parties seek class treatment pursuant to Federal Rule of Civil Procedure 23 or any State process analogous to Federal Rule of Civil Procedure 23;

(3) "Dispositive motion" means a motion asking for a court order that entirely disposes of one or more claims in favor of the party who files the motion without need for further court proceedings;

(4) "Pre-dispute arbitration agreement" means an agreement between a school and a student providing for arbitration of any future dispute between the parties; and

(5) "Mandatory pre-dispute arbitration agreement" means a pre-dispute arbitration agreement included in an enrollment agreement or other document that must be executed by the student as a condition for enrollment at the school.

* * * * *

34. Section 685.308 is amended by revising paragraph (a) to read as follows:

<u>§685.308 Remedial actions</u>.

(a) The Secretary collects from the school the amount of the losses the Secretary incurs and determines that the institution is liable to repay under §§685.206, 685.214, 685.215(a)(1)(i), (ii), or (iii), 685.216, or 685.222 or that were disbursed--

(1) To an individual, because of an act or omission of the school, in amounts that the individual was not eligible to receive; or

(2) Because of the school's violation of a Federal statute or regulation.

* * * * *

35. Section 685.310 is added to subpart C to read as follows:

§685.310 Severability.

If any provision of this subpart or its application to any person, act, or practice is held invalid, the remainder of the subpart or the application of its provisions to any person, act, or practice shall not be affected thereby.

(Authority: 20 U.S.C. 1087a et seq.)

PART 686--TEACHER EDUCATION ASSISTANCE FOR COLLEGE AND HIGHER EDUCATION (TEACH) GRANT PROGRAM

36. The authority citation for part 686 continues to read as follows:

AUTHORITY: 20 U.S.C. 1070g, et seq., unless otherwise noted.

37. Section 686.42 is amended by revising paragraph (a) to read as follows:

§686.42 Discharge of an agreement to serve.

(a) Death. (1) If a grant recipient dies, the Secretary discharges the obligation to complete the agreement to serve based on--

(i) An original or certified copy of the death certificate;

(ii) An accurate and complete photocopy of the original or certified copy of the death certificate;

(iii) An accurate and complete original or certified copy of the death certificate that is scanned and submitted electronically or sent by facsimile transmission; or

(iv) Verification of the grant recipient's death through an authoritative Federal or State electronic database approved for use by the Secretary.

(2) Under exceptional circumstances and on a case-by-case basis, the Secretary discharges the obligation to complete the agreement to serve based on other reliable documentation of the grant recipient's death that is acceptable to the Secretary.

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