
Docket ID ED–2023-OPE-0089

Dear Secretary Cardona & Under Secretary Kvaal,

The National Student Legal Defense Network (“Student Defense”)\(^1\) writes in response to the request for comments on the Notice of Proposed Rulemaking (“NPRM”) published in the Federal Register on May 19, 2023.\(^2\) The NPRM addresses many issues facing student loan borrowers and the Department’s oversight of the programs authorized by Title IV of the Higher Education Act (“HEA”). Pub. L. No. 89-329, § 401 et seq., 79 Stat. 1219, 1232 (codified as amended at 20 U.S.C. §§ 1070 et seq.). Although we are submitting comments on the Department’s “Gainful Employment” proposal, we focus specifically in this comment on the Department’s proposals, statements, and actions regarding Certification Procedures, Administrative Capability and Financial Responsibility for institutions participating in Title IV.

I. The Department’s Regulations and Practices Regarding the Length of Provisional Certification Must Comply with the Higher Education Act.

Under HEA § 498(h), institutions are allowed to participate under provisional certification for “not more than three complete award years.” See 20 U.S.C. 1099c(h). Nevertheless, longstanding regulations governing provisional certification—both as written and applied—have unlawfully created a loophole eviscerating this statutory requirement. See, e.g., 34 C.F.R. § 668.175(f)(3) (allowing renewal of a provisional certification at the end of the period of certification irrespective of the length of prior provisional certification). In practice, the Department has routinely allowed institutions to participate provisionally in Title IV for more than the statutory three-year cap by using consecutive agreements, each of which is less than the statutory maximum. The Department must bring its regulations and practices into compliance with the law.

The Department’s policy of ignoring the three-year cap appears rooted in its 1994 policy allowing institutions that “have participated successfully under provisional certification, but who still do not

\(^1\) Student Defense is a non-partisan organization, recognized as non-profit under section 501(c)(3) of the Internal Revenue Code, that works, through litigation and advocacy, to advance students’ rights to educational opportunity and to ensure that higher education provides a launching point for economic mobility.

satisfy certain requirements for full certification . . . to renew their provisional certification.” At the time this interpretation was put forth, the Department did not believe that it needed to put language to this regard in regulation, “because such decisions will be made in response to applications for certification that institutions will submit in response to the expiration of their current certifications.”

This rationale is, at best, unclear; the Department never indicated in 1994 what it meant for a school to have “participated successfully.” Nor did it explain how its interpretation complied with the statutory language or intent (i.e., even if individualized decisions are made, how does this comply with the plain language of the HEA?).

In 1997, the Department enshrined this policy in regulations governing the “Provisional Certification Alternative,” which is—itself—a regulatory loophole that allows institutions that are not financially responsible to nevertheless participate in the Title IV programs. See 34 C.F.R. § 668.175(f)(3) (permitting, “at the end of the period for which the Secretary provisionally certified the institution,” the Secretary to “again permit the institution to participate under a provisional certification”). When adopting this regulation, the Department again failed to square this policy with the statutory text. And the Department has never justified its loophole around the statutory cap, which is especially jarring because the provisional certification alternative is an exception to the statutory requirement that institutions must be financially responsible to participate in the Title IV programs.

The Department’s interpretation assumes that Congress intended to limit only the term of a given certification period, but not prohibit serial terms. That reading ignores common sense, the plain text of the statute, and key textual evidence indicating that this was not what Congress intended. It defies logic that Congress would place a six-year cap on ordinary recertification decisions, see HEA § 498(g), 20 U.S.C. § 1099c(g) (referring in the header to “[t]ime limitations on, and renewal of, eligibility” (emphasis added). Of course, the “title of a statute and the heading of a section” are “tools available for the resolution of a doubt” about the meaning of a statute. See Bldg. of R.R. Trainmen v. Balt. & Ohio R.R. Co., 331 U.S. 519, 528-529 (1947); INS v. Nat’l Ctr. for Immigrants’ Rights, Inc, 502 U.S. 183, 189 (1991) (“[T]he title of a statute or section can aid in resolving an ambiguity in the legislation’s text.”).

Student Defense noted these concerns previously during this Rulemaking. During Day 2 of Session 2 of the 2022 Institutional and Programmatic Eligibility Negotiated Rulemaking (February 15, 2022), one of the negotiated rulemaking committee members presented a legal memorandum from Student Defense detailing numerous legal flaws in the Department’s current regulations and practices.⁶

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⁶ Id.
⁷ HEA § 498(g), 20 U.S.C. § 1099c(g) (referring in the header to “[t]ime limitations on, and renewal of, eligibility” (emphasis added). Of course, the “title of a statute and the heading of a section” are “tools available for the resolution of a doubt” about the meaning of a statute. See Bldg. of R.R. Trainmen v. Balt. & Ohio R.R. Co., 331 U.S. 519, 528-529 (1947); INS v. Nat’l Ctr. for Immigrants’ Rights, Inc, 502 U.S. 183, 189 (1991) (“[T]he title of a statute or section can aid in resolving an ambiguity in the legislation’s text.”).
Among its topics, Student Defense highlighted how the Department’s regulations and practices have “routinely” allowed institutions to participate under provisional certification for more than three years, despite an unambiguous three year statutory cap on the practice.\footnote{Legal Memo at 4.}

Student Defense also raised this concern through comments on the Department’s previous Notice of Proposed Rulemaking on Institutional Eligibility, Student Assistance General Provisions, and Federal Pell Grant Program, Docket ID ED-2022-OPE-0062, 87 Fed. Reg. 45,432 (July 28, 2022). In a Final Rule published on October 28, 2022, the Department—seemingly referencing the Student Defense comment—noted that “[s]ome commenters recommended an institution may only participate under a provisional PPA for a total consecutive period of 3 years and at the expiration, the institution must have executed a non-provisional PPA with the Department.” Final Rule, 87 Fed. Reg. 65,426, 65,463 (Oct. 28, 2002). Apart from noting the comment, the Department never responded substantively, which itself is a violation of the Administrative Procedure Act. See, e.g., Ass’n of Private Sector Colls. and Univs. v. Duncan, 681 F.3d 427, 449 (D.C. Cir. 2012) (discussing the Department’s obligation to discuss comments and remanding a rule based on the Department’s failure to satisfy its burden).

Given these legal failures, and the Department’s proposals regarding provisional certification within the NPRM, we again urge the Department to:

- Remove 34 C.F.R. § 668.175(f)(3) and clarify that provisional certification is only allowed for three consecutive years, irrespective of the term of any individual certification.
- Within 34 C.F.R. § 668.175(g), clarify that provisional certification is only allowed for three consecutive years, irrespective of the term of any individual certification.

Under this proposal,\footnote{This proposal is plainly a “logical outgrowth” of the NPRM. First, the proposal was submitted previously included within the Legal Memo presented to the Department during negotiated rulemaking. See Legal Memo, supra n. 6. Second, the Department has specifically asked for comment regarding the length of provisional certification. See 97 Fed. Reg. 32300-01. Third, despite the APA’s “logical outgrowth” requirement, the Department is “free” and “encouraged” to “modify proposed rules as a result of the comments” it receives. N.E. Md. Waste Disposal Auth. v. EPA, 358 F.3d 936, 951 (D.C. Cir. 2004); Ariz. Pub. Serv. Co. v. EPA, 211 F.3d 1280, 1300 (D.C. Cir. 2000) (“the purpose of notice and comment rulemaking has been served, and . . . the Agency’s change of heart on this issue only demonstrates the value of the comments it received”). Moreover, requiring a final rule to be identical to the NPRM “would lead to the absurdity that in rule-making under the APA the agency can learn from the comments on its proposals only at the peril of starting a new procedural round of commentary.” Int’l Harvester Co. v. Ruckelshaus, 478 F.2d 615, 632 n.51 (D.C. Cir. 1973).} institutions that are still not financially responsible after the end of the provisional period would not be without options. Although such institutions would not be allowed to participate under either 34 C.F.R § 668.175(f) or 34 C.F.R. § 668.175(g) for more than three years, the Department would be well-within its authority to allow such institutions to participate under 34 C.F.R. § 668.175(c). Subsection 668.175(c) allows institutions that cannot meet the financial responsibility standards to participate in Title IV by submitting a larger letter of credit to satisfy...
potential losses to the government. This regulatory alternative falls within the boundaries set by Congress in the HEA. HEA § 498(c)(3)(A), 20 U.S.C. § 1099c(c)(3)(A) (allowing institutions not financially responsible to participate in Title IV upon submitting a financial guarantee of not less than 50% of “annual potential liabilities” to the Department).9

Of course, if the Department adopts this proposal, it must take additional steps to mitigate the loss of enforcement flexibility that comes with provisional certification. In such cases—particularly where there is evidence of continuous financial responsibility failures—the Department can shorten the length of any PPA certification for institutions participating after the expiration of a provisional PPA. The Department could also include other, specifically-tailored conditions to facilitate oversight appropriate for an institution that has not been able to cure financial responsibility failures after three years of provisional certification.10

II. Proposed Regulations Designed to Hold Parent Entities/Investors Liable for Losses Are Simultaneously Unnecessary and Inadequate.

Student Defense has long advocated for the Department to use its unambiguous statutory authority to hold wrongdoers financially accountable for scamming students and fleecing taxpayers. In a 2020 report, Protection and the Unseen: Holding Executives Personally Liable under the Higher Education Act,11 Student Defense brought the issue of personal (and corporate parent) liability front-and-center to the discussion of protecting students and taxpayers. Student Defense remains concerned with the Department’s unwillingness to use the statutory authority.

To be clear: the Department’s authorities regarding personal liability are neither unclear nor new. Rather, on the heels of a bipartisan Senate investigation reporting on abuses in the federal student aid programs led by Senator Sam Nunn, and in connection with the 1992 reauthorization of the HEA, Congress added provisions giving the Department authority—and in some cases a mandate—to recover financial losses from individuals who “exercise substantial control over [an] institution,” i.e., individuals who “directly or indirectly” control a “substantial ownership interest in the institution,” and individuals who are “member[s] of the board of directors, the chief executive officer, or other executive officer of the institution or of an entity that holds a substantial ownership interest in the institution.”

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9 But see infra (discussing problems with 34 CFR 668.175(c)).
10 Apart from the Department’s evisceration of the statutory three-year cap, the Department’s reliance on Provisional Certification to mitigate nearly all financial responsibility failures is inconsistent with the HEA’s limited and discrete authorization of provisional certification. See HEA § 498(h)(1)(A)–(B). Indeed, the HEA strongly suggests that—absent a change in ownership or loss of accreditation—the Department may only use provisional certification for a participating school when it “seeks to renew its certification.” HEA § 498(h)(1)(B)(iii). These limiting words were not in the statute as amended in 1992, but were specifically added to the statute via the Higher Education Technical Amendments of 1993. Pub. L. 103-208 (1993), 107 Stat. 2480. See also Comm. on Educ. and Labor, Subcomm. on Postsecondary Education, Legislative Recommendations for Reauthorization of The Higher Education Act and Related Measures, Part IV, Title IV, CWS, NSDL, Need Analysis, General Provisions, Miscellaneous at *250 (May 1991).

Although strict statutory adherence may place impractical formalities over function, the language does suggest that provisional certification is narrowly limited to circumstances in which the Department use additional standards to mitigate failures and which are grounded within the HEA’s financial responsibility standards.

interest in the institution” (collectively, the “Institutional Control Group”).

These provisions were also specifically recommended by the Department’s Inspector General, who testified before the U.S. House of Representatives Committee on Education and Labor that:

“the HEA should be amended to require owners of corporate proprietary schools to be personally liable for school losses. Current law allows Title IV participation by corporate proprietary schools, but does not provide a means of holding school owners personally liable for losses caused by a school’s failure. Thus, when schools close or otherwise fail to meet their financial responsibilities, owners are able to escape with large personal profits while the taxpayer and student are left to pay the bill.”

In addition, the Inspector General recommended that the law “ensure that school owners are held personally liable for the accuracy of information, claims or other statements on which institutional eligibility is based.”

Despite this unambiguous Congressional intent and the clear statutory language, to our knowledge, the Department has never successfully used these authorities to impose and collect administratively assessed liabilities from members of an Institutional Control Group who exercise “substantial control” over an institution with unpaid administrative debts to the Department. The costs of these failures are real—both in terms of financial losses and the failure, by the Department, to use one of the strongest tools it possesses to deter future misconduct.

The Department must do better. Although acknowledging the authority is a step in the right direction (in terms of creating a deterrent effect), we are concerned that the Department’s recent electronic announcements EA GEN-22-16 (entity liability) and EA GEN-23-11 (personal liability), are overly limiting and will not have the intended effect.

Student Defense urges the Department to rethink aspects of the NPRM in critical respects. We also urge the Department to strengthen the corresponding language in EA GEN-22-16 (and, by extension in EA GEN-23-11) to better protect students and taxpayers.

a. The proposed signature requirement in 34 C.F.R. § 668.14(a)(3) is unnecessary, bad policy, and inconsistent with current regulations.

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12 See P.L. 102-325 § 498 (July 23, 1992) (adding HEA § 498(e)(1), 20 U.S.C. § 1099c(e)(1)(B)). In that same legislation, Congress added other specific references to individual liability, including, for example, in the context of closed school loan and false certification discharges. See P.L. 102-325 § 428 (amending HEA § 437 to include § 437(e)(1), 20 U.S.C. § 1087(c)(1) and requiring the Secretary to discharge such loans and to “pursue any claim available to such borrower against the institution and its affiliates and principals”) (emphasis added). Separately, the HEA provides that if an “individual” “willfully fails to pay” or “willfully attempts in any manner to evade payment of” a refund owed to the Department, such individual may be liable “as a responsible person for a penalty under section 6672(a)” of the Internal Revenue Code of 1986, with respect to the nonpayment of taxes. HEA § 498(e)(6), 20 U.S.C. § 1099c(e)(6); HEA § 437(e)(1), 20 U.S.C. § 1087(c)(1).


14 Id.
As noted, Student Defense supports the Department’s view that “[t]o protect taxpayers and students . . . entities that exert control over institutions should assume responsibility for institutional liabilities.” 88 Fed. Reg. at 32,379. Student Defense agrees that requiring such entities to assume liability “provides protection in the event that an institution fails to pay its liabilities, which has been a recurring problem.” Id. This problem has cost taxpayers more than $1 billion, as a recent Student Defense report has established.15

i. The Signature Requirement is Unnecessary. Student Defense disagrees that entities must sign the PPA in advance in order to be held financially liable. As an initial matter, there is nothing in the Higher Education Act that requires signatures. Rather, the HEA provides numerous textual clues that suggest otherwise. For example, HEA § 498(e), 20 U.S.C. § 1099c(e), starts with the words “[n]otwithstanding any other provision of law, the Secretary may, to the extent necessary to protect the financial interest of the United States.” These words are broad—and assume that “any other provision[s] of law” are not applicable. The Secretary therefore has broad power to invoke the authorities within § 498(e), and simply does not need to have obtained a signature in advance in order to invoke that authority. This reading of the statute is confirmed through § 498(e)(4), which enumerates specific circumstances in which the Department may not impose the statutory liability requirements. Under the doctrine expressio unius est exclusion alterius—the expression of one thing implies the exclusion of others—the list in HEA § 498(e) represents the complete set of circumstances in which the Department is prohibited from exercising its authority in § 498(e)(1)(A)–(B). In this case, “circumstances support[] a sensible inference that the term left out,” i.e., PPA signature, “must have meant to be excluded.” NLRB v. SW Gen., Inc., 580 U.S. 288, 302 (2017) (quoting Marx v. Gen. Revenue Corp., 568 U.S. 371, 381 (2013)).

ii. The Signature Requirement is Bad Policy. The Department’s signature requirement is also bad policy because it requires the Department to predict, in advance, whether an individual or parent company must sign the PPA. If the Department is taking the position that a corporate parent (or individual) must sign the PPA in advance of creating losses to the government, what happens with the Department fails to accurately predict the losses? Likewise, under the proposed 50 percent threshold, if an institution causes massive losses to taxpayers, is an entity with 49 percent ownership going to walk away without consequence because it was not required to pre-sign a PPA? By setting this signature requirement, the Department is almost guaranteeing that owners will stay under a 49% threshold or use corporate structures to avoid signature requirements.

iii. The 50 Percent Threshold is Unsupported and Conflicts with Longstanding Department Policy. The NPRM proposes to modify the PPA signature requirements for proprietary and private nonprofit institutions to require the signature of an “authorized representative of an entity with direct or indirect ownership of the institution if the entity has the power to exercise control over the institution.” 88 Fed. Reg. at 32,491. The NPRM further proposes—as an “example” of such a circumstance—a situation where the “entity has at least 50 percent control over the institution[]” Id. at 32,491-92. This language mirrors statements in EA GEN-

22-16, in which the Department stated that “[s]ubstantial control is generally presumed to be any direct or indirect equity, membership or voting interest of 50 percent or more in the institution.”

The Department’s statements in the NPRM and EA GEN-22-16 constitute an unexplained departure from longstanding—and current—Department regulations regarding “substantial control” which provide in 34 C.F.R. § 668.174(c)(3):

(3) The Secretary **generally considers a person or entity to exercise substantial control** over an institution or third-party servicer if the person or entity—

(i) **Directly or indirectly holds at least a 25 percent ownership interest** in the institution or servicer;

(ii) Holds, together with other members of his or her family, **at least a 25 percent ownership interest** in the institution or servicer;

(iii) Represents, either alone or together with other persons under a voting trust, power of attorney, proxy, or similar agreement, one or more persons who hold, either individually or in combination with the other persons represented or the person representing them, **at least a 25 percent ownership** in the institution or servicer; or

(iv) Is a member of the board of directors, a general partner, the chief executive officer, or other executive officer of—

(A) The institution or servicer; or

(B) An entity that holds at least a **25 percent ownership interest** in the institution or servicer

For decades, the Department has considered “a person to exercise substantial control over an institution . . . if the person . . . directly or indirectly holds at least a 25 percent ownership interest in the institution or servicer.” In 1989, the Department took the position that “[c]learly, the ownership of more than 50% of an institution or its parent corporation confers an ability to affect, and even control, the actions of that institution. However, these proposed regulations reflect the fact that the Secretary also considers the ownership of at least 25% of the stock of an institution or its parent corporation generally to constitute ability to affect substantially the actions of the institution.”16 Finalizing that Rule in 1991, the Department wrote that “there are circumstances under which the Secretary considers a person to have the ability to affect substantially the actions of an institution **even when that person does not have a controlling interest in that institution or**

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the institution’s parent corporation.” And the Department’s statement regarding “substantial control” remains in the regulations today, with no proposals to change that.

The proposal in the NPRM, like the policy outlined in EA GEN-22-16, completely disregard decades of Departmental policy without any explanation. Indeed, the only justification provided for the 50 percent threshold is that “owning more than 50 percent is considered a simple majority,” so therefore “we believe this is a suitable percent to use as the threshold.” 88 Fed. Reg. at 32,379. And although the Department’s math is incontrovertible (insofar as X>50% means that X>1/2), this is not the kind of reasoning that supports a regulation. Moreover, the statements in the NPRM regarding “substantial control” undermine the basis for the Department’s definition of substantial control in 34 C.F.R. § 668.174.

Finally, the Department has not described—and perhaps not considered—other options. the Department has not explained why it is not drawing from the Internal Revenue Code’s use of a thirty-five percent threshold for “disqualified” individuals with respect to private foundations. See 26 U.S.C. § 4946. Under the I.R.C., the term “disqualified person” is vital to the determination and status of exempt organizations classified as a private foundation; and in addition, Congress provided a list of disqualified persons with respect to a private foundation. In this context:

- **A Corporation** is a disqualified person if a substantial contributor, foundation manager, 20 percent owner, or the family members of any such individuals, own more than 35 percent of the total combined voting power in the corporation. This includes constructive holdings.

- **A Partnership** is a disqualified person when a substantial contributor, foundation manager, 20 percent owner, or the family members of any such individuals, own more than 35 percent of the profits interest in the partnership. This includes constructive holdings.

- **Trusts or Estates** are a disqualified person when more than 35 percent of the beneficial interest in the trust or the estate is owned by a substantial contributor, foundation manager, 20 percent owner and family members. This includes constructive holdings.


Although we do not believe that any signature requirement is necessary, if the Department is going to continue down this misguided path, it should use a 25% threshold, given the language of 34 C.F.R § 668.174(c)(3). Nevertheless, there are reasoned options other than 50% that would provide stronger protections for taxpayers and stronger deterrents for entities.

b. If the Department is going to require signatures before holding parent entities and investors liable, it should not leave out individuals.

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As discussed above, Student Defense strongly urges the Department to reconsider its apparent position that signatures on a PPA are necessary before a controlling entity can be held liable. However, to the extent the Department continues to believe this to be the case, we are troubled by the fact that the proposed regulation is tailored only to entity liability but ignores personal liability.

Given the Department’s issuance of EA GEN-22-16 (Entity Liability) on March 23, 2022, and its subsequent issuance of EA GEN-23-11 (Personal Liability) on March 1, 2023, we see no reason why both issues would not be considered in the final rule.

III. The Department’s Regulations Regarding Setting of Surety Amounts are Contrary to Law.

The NPRM also proposes a variety of changes to the Financial Responsibility regulations, including changes to 34 C.F.R. § 668.171(c) that “revise the set of conditions” that automatically require institutions to post financial protection if the event occurs as prescribed in the regulation.” 88 Fed. Reg. at 32,303. The NPRM also proposes amendments to 34 C.F.R. § 668.171(d) to “revise the set of conditions that may, at the discretion of the Department, require posting of financial protection if the event occurs as prescribed in the regulations.” Id. As stated by the Department, a key purpose of these changes is “to better protect student and taxpayers in cases of institutional misconduct and closure.” Id. at 32,313; see also id. at 32,353 (noting that “the Department often finds itself unable to collect any liabilities owed to the Federal government due to the insolvency of the closed institution. Obtaining financial surety prior to a closure would help to offset these types of liabilities.”).

Student Defense continues to have substantial concerns regarding the Department’s regulations and practices regarding the amount of the “financial protection” (also referred to as a “surety” and often in the form of a “letter of credit”) that the Department requires institutions to post in the event of a financial responsibility failure.

Under the HEA, which commands that institutions may only participate in Title IV if the Department determines them to be “financially responsible,” an institution failing the general standards outlined in HEA § 498(c)(1) and the composite score test will still be considered financially responsible if it meets one of four conditions. One such condition—set forth in HEA § 498(c)(3)(A)—is the “Statutory 50% Exception,” where an institution is considered financially responsible if it meets the composite score formula.

Student Defense raised these concerns previously both in the Legal Memo, see supra n. 6, and during the Department’s recent rulemaking encompassing change-in-ownership (“CIO”) issues. See Final Regulations, Pell Grants for Prison Education Programs; Determining the Amount of Federal Education Assistance Funds Received by Institutions of Higher Education (90/10); Change in Ownership and Change in Control, 87 Fed. Reg. 65,426, 65,464 (Oct. 28, 2022). A copy of the Student Defense comment can be found here: https://defendstudents.org/letters/document/2022.08.26-Change-in-Ownership-Comment-final.pdf.

Responding to this point in the Final Rule, the Department indicated the “50 percent” LOC requirement wasn’t how the Department proceeded when institutions failed to meet the financial ratios. 87 Fed. Reg. at 65,464 (“With respect to the comment that said that the minimum requirement must be 50 percent, the financial protection addressed in the regulation is not the financial protection required when an institution fails to meet the ratios described in the HEA.”). But that is inaccurate (as to the substance of the comment), incorrect (as a matter of law), and misses the point. The comment specifically focused on the denominator of the 50 percent calculation — not that it “must be 50 percent.” The question in that comment, restated here, is fifty percent of what. As a legal matter, the statement in the Final Rule was incorrect because the Department’s longstanding expressly contemplate the use of the 50 percent LOC requirement as an option for institutions that fail the composite score formula. See 34 C.F.R. § 668.175(c).
responsible if it provides the Department with a “third-party financial guarantee” equal to “not less than one-half of the annual potential liabilities of such institution to the Secretary for funds under [Title IV].”

The Department has long purported to mirror this alternative in its regulatory “Financial Protection Alternative” (“FPA”). See 34 C.F.R. § 668.175(c). Under the FPA, an institution demonstrates financial responsibility by submitting “an irrevocable letter of credit” or “other financial protection” approved by the Secretary that is “not less than one-half of the annual potential liabilities of such institution to the Secretary for funds under this title, including loan obligations discharged pursuant to section 437, and to students for refunds of institutional charges under this title.”

The NPRM proposes to keep this requirement. 88 Fed. Reg. 32,503 (proposing 34 C.F.R. § 668.175(c)). The Department has also imported the concept of a financial guarantee into other regulations, including the Provisional Certification Alternatives (“PCAs”) set forth in 34 C.F.R. § 668.175(f)–(g). In the case of institutions opting to participate under a PCA, an institution must provide a financial guarantee, which can be less than the 50% requirement in HEA § 498(c)(3)(A), but must, by regulation, be no less than 10 percent of the institution’s prior year title IV funding. The NPRM proposes to keep this language in each PCA. See 88 Fed. Reg. 32,504 (proposing 34 C.F.R. §668.175(f)(2)(i) & making no proposals regarding 34 C.F.R. § 668.175(g)).

### A. The Department’s Regulations Do Not Comply with the Statutory 50% Exception

Because They Vastly Underestimate Potential Taxpayer Costs.

The Statutory 50% Exception allows institutions that are not financially responsible to participate in Title IV programs as if they are financially responsible, if they provide the Department a guarantee not less than 50% of the “annual potential liabilities” of the institution resulting from participation in Title IV. While the regulatory FPA and the NPRM purport to apply this language, it is materially different from the statute.

Whereas the statute requires—as the denominator in the 50% calculation—a guarantee to cover “one-half of the annual potential liabilities,” the FPA requires the guarantee to cover “one-half of the title IV HEA program funds received by the institution” during the prior year, which almost certainly undercounts an institution’s “annual potential liabilities.”

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<tr>
<th>Statutory 50% Exception: HEA § 498(c)(3)(A)</th>
<th>Financial Protection Alternative: 34 C.F.R. § 668.175(c) &amp; NPRM</th>
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<td>Requires a guarantee “not less than one-half of the annual potential liabilities . . . to the Secretary for funds under this title, including loan obligations discharged pursuant to section 437, and to students for refunds of institutional charges under this title.”</td>
<td>Requires an “irrevocable letter of credit” (or other appropriate instrument) “for an amount determined by the Secretary, that is not less than one-half of the title IV, HEA program funds received by the institution during its most recently completed fiscal year.”</td>
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20 34 C.F.R. § 668.175(c). Note, this requirement “does not apply to a public institution.” Id.
21 34 C.F.R. § 668.175(f)(2)(i); 34 C.F.R. § 668.175(g)(1)(iii).
22 Current regulatory language uses the term “Secretary.” 34 C.F.R. § 668.175(c). The NPRM proposes to use “Department.” We do not comment on that change.
To understand the difference, take the case of Vatterott College, which failed the Department’s composite score every year from 2006 until its closure in December 2018. Vatterott was participating under the 34 C.F.R. § 668.175(f) Provisional Certification Alternative, not under the FPA. At the time of its closure, the Department held a surety representing 15% of the prior year’s Title IV draw.23 Had Vatterott been participating under the FPA, not the PCA, a a surety representing 50% of its prior year’s Title IV draw would have been approximately $43 million.24 But truth be told, the closure of Vatterott college ultimately led to at least a $242 million unpaid liability following the school’s 2018 closure. And although Vatterott was participating under the PCA, the point here is simple: a calculation that is based on prior year draw is clearly different from a calculation based on “annual potential liabilities.”

During the 1997 rulemaking establishing the FPA within Subpart L,25 the Department received comments on this exact point: i.e., that its (then-proposed) regulation language basing the financial protection on prior year Title IV revenue, rather than “annual potential liabilities,” contradicted the HEA.26 In response, the Department proclaimed its approach “reasonable,” “especially since the law takes into consideration the value of potential loan discharges and unpaid student refunds.”27 But the Department neither showed any analysis nor explained how a prior year’s Title IV draw could serve as a proxy for potential closed school discharges, which—particularly for multi-year programs—could vastly exceed the prior year’s Title IV draw. Nor did the Department explain how this approach conforms to Congressional intent.28

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24 Vatterott reportedly posted a 15% surety, totaling $12,882,632. Assuming this figure represented 15% of the Title IV draw, the total Title IV draw would have been approximately $85 million. See id.
25 Between 1994 and 1997, the precursor to the Financial Protection Alternative was found in 34 C.F.R. § 668.15(d)(2)(i).
26 Student Assistance General Provisions, 62 Fed. Reg. 62,830-01, 62863 (Nov. 25, 1997) (“Many commenters maintained that the proposed rules continue to contradict statutory language in specifying that letters of credit be for one-half of all annual title IV, HEA disbursements, rather than for one-half of potential annual liabilities.”)
27 When the Department first proposed the 1994 version of the financial protection alternative, it stated that although “an institution is liable for all mishandled Title IV, HEA program funds that it receives,” it believed that the “total Title IV, HEA program funds received by an institution during the last complete award year is the best indicator of the amount of Title IV, HEA program assistance that the institution will receive for the next award year. Therefore, the Secretary proposes to require an institution to submit a letter of credit equal to not less than one-half of the Title IV, HEA program funds received by the institution during the last complete award year for which figures are available in order to meet this requirement.” Student Assistance General Provisions and Federal Pell Grant Program, Notice of Proposed Rulemaking 59 Fed. Reg. 9526, 9544 (Feb. 28, 1994).
On its face, the Department’s unexplained position regarding the FPA is inconsistent with the text of the HEA. From a policy perspective, the problem is clear: basing a surety solely on one year’s Title IV draw fails to protect taxpayers from losses associated with a closure. Liabilities from closed school discharges and borrower defense, for example, are simply not tied to a single year.

We therefore propose that the Department take the following steps to bring the regulatory FPA in compliance with law:

- The Financial Protection Alternative must be based on annual potential liabilities, as determined by the Department, not simply on a school’s prior year’s Title IV draw. Liabilities do not disappear from one year to the next and include the potential costs due of loan forgiveness from debts incurred prior to the immediately preceding year.

**B. The 10% Letter of Credit Floor Under the Provisional Certification Alternatives is Arbitrary.**

As noted above, the Department also uses a surety requirement as part of the Provisional Certification Alternatives set forth in 34 C.F.R. §§ 668.175(f)-(g). Those regulations require institutions to post a minimum surety of 10% of the prior year’s Title IV funding; the Department, in its discretion, can require more.

Apart from the policy flaws with the “prior year funding” denominator, described above, the Department’s use of that denominator in this context is particularly inadequate in those circumstances where the HEA requires the Department to determine that an institution has the “ability to meet all of its financial obligations (including refunds of institutional charges and repayments to the Secretary for liabilities and debts incurred in programs administered by the Secretary).”

The above-described issues with the denominator strongly suggest that the 10% floor is insufficient.

In adopting the regulation, the Department attempted to counter this exact criticism, noting that “the amount of Title IV, HEA program funds received by an institution during the last complete award year for which figures are available provides the most accurate indication of the amount of Title IV, HEA program funds the institution will use in the next award year.” But for the reasons stated above, this statement is irrelevant because potential liabilities is not the same as the subsequent year’s anticipated funding.

Moreover, the Department has never articulated a basis for the numerator (the 10% floor), also rendering the rule potentially arbitrary under the APA. Rather, the Department has only stated—in conclusory terms and without data or analysis—that “10 percent of an institution’s Title IV, HEA program funds is the minimum necessary to ensure repayment of liabilities that may be identified

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29 HEA §498(c)(3)(C), 20 U.S.C. § 1099c(c)(3)(C). With respect to institutions to non-public institutions that have failed the composite score, absent compliance with this statutory requirement, it is unclear what authority the Department would have to qualify an institution as financially responsible.


during the institution’s period of provisional certification.” Nor has the Department ever publicly described its methodology for determining when, and how, to exercise its authority to require a surety above that minimum floor. At the same time, a majority of sureties held by the Department (as of February 2020) from schools participating under the Provisional Certification Authority due to composite score failures were set at 10% (and an overwhelming majority are set at either 10 or 15%).

Considering these issues, the Department should analyze data within its possession to assess whether a letter of credit of 10% of the prior year’s Title IV draw is sufficient to cover losses to the federal government (associated with loan discharges or otherwise).

IV. The Final Rule Should Make Exceedingly Clear that non-Exhaustive Lists are Truly non-Exhaustive.

The Department has proposed amending 34 C.F.R. § 668.14(e) “to establish a non-exhaustive list of conditions that the Secretary may apply to provisionally certified institutions, such as the submission of a teach-out plan or agreement.” 87 Fed. Reg. 32,304; see also, e.g., id. at 32,320, 32,384. Although Student Defense supports the inclusion of these additional factors, we wish to emphasize the importance of the Department’s statement that it is proposing “a non-exhaustive list because we do not want to foreclose any current flexibility that we have with respect to monitoring provisionally certified institutions[.]” Id. at 32,384. Student Defense strongly encourages the Department to repeat this language in the preamble to the final rule to emphasize the Department’s existing legal authority.

Although we do not oppose the Department’s additional statement that it will “publish updates to the list as needed,” id., we ask the Department to clarify that its failure to publish such an “update” in advance of its inclusion of a new condition in a provisional PPA does not limit the Department’s authority to include such a condition in a provisional PPA.


The proposed changes to the financial responsibility triggers (both mandatory and discretionary) strengthen the Department’s ability to ensure that institutions have the requisite financial responsibility to participate in Title IV programs and serve as a fiduciary of federal and student funds. At a high level, Student Defense supports the Department’s restoration of financial responsibility standards enacted as part of the 2016 Borrower Defense Rule, which were removed in 2019. We do, however, suggest additional changes—logical outgrowths of the proposal—to further ensure institutional financial responsibility and protect students and taxpayers.

a. Include discretionary triggers that incorporate third-party measures of financial distress.

Recognizing the difficulties associated with measuring the financial health of an institution, the Department should add discretionary triggers based on third-party measures of financial distress.

Including these items as triggering events would allow the Department to take advantage of informational advantages from public or private credit markets. Such market participants may provide more up-to-date insights into an institution’s current financial health than information provided by other reported statements.

For example, where an institution is rated by a credit rating agency (often those with publicly traded debt), the Department should include a discretionary trigger premised on sufficiently low bond ratings, e.g., “junk bond” ratings (generally below Baa2/BBB based on the Moody’s/S&P credit rating scales, respectively). The Department should also include a discretionary trigger that reflects increased pricing for debt (line or credit, loan agreement, security agreement, or other debt financing arrangement). This would trigger if an institution has debt outstanding that it rolls over or repays with a new loan or line of credit that has a significantly higher credit spread (e.g., a jump in credit spreads of 200 basis point in percentage (bps) above a relevant credit benchmark). This higher credit spread (benchmarked to avoid considering extraneous market fluctuations) would indicate a significant decline in credit quality for the institution based on reviews by third-party lenders.

Incorporating this measure of credit risk would build on the proposed discretionary trigger based on an increase in cost or penalties from pre-existing credit provisions. This proposed regulation incorporates contractual provisions that would be triggered based on an institution’s increased credit risk, but the Department should not depend on the inclusion of terms that lead to increased pricing based on increased credit risk. It should also consider increased credit risk that is revealed when an institution borrows under new agreements.

If the Department adopts this suggestion it should include a reporting requirement in 34 C.F.R. § 668.171(f) to ensure that the institution provides relevant information in a timely manner.

b. Amend 34 C.F.R § 668.171(d)(1) to include “financial risk.”

Accreditors and states often undertake reviews of institutional financial stability. The Department should take advantage of these reviews by incorporating key findings as a discretionary trigger. Indeed, the Department already considers reviews by accreditors and state agencies as a discretionary trigger. We suggest that the Department modify that language to include findings of financial distress or significant risk of financial distress that may fall short of “probation” or the issuance of a “show-cause order.” We suggest the following language:

(1) Accrediting agency and government agency actions. The institution’s accrediting agency or a Federal, State, local, or Tribal authority places the institution on probation,
issues a show-cause order, makes findings showing a substantial financial risk, or places the institution in a status that poses a risk to its accreditation, authorization or eligibility.

c. Include a discretionary trigger based on the presence of substantial short-term and contingent liabilities as a discretionary trigger under 34 C.F.R. § 668.171(d).

The Department’s proposed regulation includes a number of risks based on the presence of debts and liabilities but does not generally account for different risk profiles from different types of debt or debt-like instruments. See e.g. 34 C.F.R. § 668.171(c)(2)(i) (reviewing triggers based on debt and liabilities). The Department should incorporate the greater riskiness of short-term and contingent debt as a discretionary trigger because inappropriate levels of short-term debt present greater risks of financial instability to the institution.

Including a significant portion of short-term and contingent debt as a trigger would reduce the risk of an institution’s abrupt failure due to the inability to repay such short-term debts.

d. Include additional considerations of significant fluctuations in revenue as a discretionary trigger under § 668.171(d)(3).

The Department proposes to reinstate a 2016 rule and add a discretionary trigger where 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.” See 34 C.F.R. § 668.171(d)(3). We suggest that the Department expand on this proposal to incorporate other changes in revenue. This includes triggers based on significant expansions or contractions from revenue derived from online degree or non-degree programs. This would identify institutions facing declines in traditional programs that mask these declines by relying more heavily on online or non-degree programs.

To apply this regulation, the Department would review audited financial statements in addition to awards from Direct Loan and Pell Grant funds. While fluctuations in Title IV funding may capture contractions or expansions for the bulk of institutions, the Department must be committed to uncovering contractions or expansions that show up outside of Title IV. Changes to revenue more broadly may threaten financial stability even if derived from unexpected sources. The regulation should not limit the Department’s flexibility in monitoring changes in other revenue areas.

e. Clarify the Department’s discretion to release financial protection obtained because of the triggers.

The NPRM proposes that if the Department receives financial protection as a result of the mandatory or discretionary triggers, it will consider releasing the financial protection in certain circumstances. The NPRM proposes in 34 C.F.R. § 668.171(c)(1):

“The Department will consider whether the financial protection can be released following the institution’s submission of two full fiscal years of audited financial statements following the Department’s notice that requires the posting of the financial protection. In making this
determination, the Department considers whether the administrative or financial risk caused by the event has ceased or been resolved, including full payment of all damages, fines, penalties, liabilities, or other financial relief. The Department.” (emphasis added).

The Department should clarify this regulation to be explicit that the Department has discretion to continue to require financial protection if warranted, even if the triggering event initially requiring this protection has “ceased or been resolved.” Id. Although a natural reading of the regulation does not require protection to be released (noting only that the Department will “consider” this), the regulatory text could be clearer. An (incorrect and) narrow reading of the proposal lists only a single factor (“whether the financial risk caused by the event has ceased or been resolved”) for the Department to “consider.” Such a reading may inappropriately limit the Department’s discretion to maintain required protection. For instance, an institution that triggers a need for protection because of a loss of eligibility in a separate federal program, 34 C.F.R. § 668.171(c)(2)(viii), may regain eligibility and cure this default in two years but still be financially at risk due to reasons that may be revealed during this period. Although an at-risk institution may trigger a separate (or the same) discretionary trigger, the extent of possibilities is limitless. The Department must ensure that the regulatory text reflects its flexibility to retain protections where protections are warranted.

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Thank you for your attention to these important issues. For more information, please contact Student Defense Vice President and Chief Counsel Dan Zibel at dan@defendstudents.org.

Sincerely,

The National Student Legal Defense Network