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Legal Memorandum

The Department of Education's Obligation to Reform Its Financial Responsibility Oversight

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FEBRUARY 2022

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In recent years, tens of thousands of students have been harmed by the closures of predatory colleges where—despite years of unheeded warnings—the closures were described as "abrupt" or "precipitous" or caused by sudden financial or oversight-related events. The costs of closures are dramatic, both for the students whose academic and personal lives are upended and for taxpayers who often bear the substantial costs associated with closed school loan discharges.

At the same time, the U.S. Department of Education ("Department") is tasked by Congress to play the chief "gatekeeping" role over the federal student aid programs authorized under Title IV of the Higher Education Act ("HEA"). Among the Department's responsibilities, it is required to set—and maintain—standards of "Financial Responsibility" that institutions *must* meet to enable their students to receive federal student loans and grants. *See generally* HEA § 498(c), 20 U.S.C. § 1099c(c).

As part of its ongoing Institutional and Programmatic Eligibility Rulemaking ("Rulemaking"), the Department has twice released Issue Papers proposing amendments to its Financial Responsibility regulations. Unfortunately, the proposals offered to date are insufficient and ignore the Department's multi-decade failure to align its regulations and practices with statutory requirements.

This Memorandum highlights certain of those failures and recommends the Department take the following steps to comply with the law:

1. **The Department must change its regulations to comply with statutory, temporal limitations on the use of provisional Title IV participation.** The HEA permits the Department, in narrowly prescribed circumstances, to provisionally certify an institution for ***a maximum of three years.*** The Department has, by its own admission, often ignored this limitation, allowing institutions to remain on provisional certification for far longer. This has proved costly to students and taxpayers alike. Institutions that do not satisfy the general financial responsibility standards after three years of provisional certification must only be allowed to participate in Title IV if they qualify under a separate statutory and regulatory alternative, and under conditions that reflect and mitigate the underlying failures.
2. **To ensure the Department is obtaining ample financial protections to guard against taxpayer losses from school closures and institutional misconduct, the Department must align its regulations and practices with the statutory financial responsibility standards.** Currently, the Department's regulations tie financial sureties to prior year funding levels, which ignore the full extent of potential liabilities and financial losses. Moreover, the Department's reliance on a 10% floor as a surety for provisionally certified institutions has no evidentiary basis.

BACKGROUND

Any discussion of the Financial Responsibility regulations cannot ignore their history and the history of the underlying HEA authorities. In 1990, a bipartisan investigatory committee led by Senator Sam Nunn concluded that there was "a virtually complete breakdown in effective regulation and oversight [under Title IV] [that] had opened the door for fraud, abuse, and other serious problems at every level."[1] That same year, the Department's Inspector General concluded that the Department certified "practically all schools that applied to participate in Title IV programs" despite massive financial problems, including instances of "negative net worth, net losses, and assets of only one-third their liabilities."[2]

Informed by these findings and extensive testimony,[3] Congress reauthorized the HEA in 1992 with "major changes to enhance the integrity of the student financial aid programs,"[4] including with respect to Financial Responsibility. The overarching message was clear: there was an urgent need for reforms to guard against fraud, abuse, and taxpayer loss in the Title IV programs.

Thirty years later, many of the same problems persist. Students continue to suffer at the hands of predatory institutions that fail to provide opportunities commensurate with cost and debt levels. Taxpayers absorb substantial financial costs of student loan discharges that result from fraud and abuse in the system. Abrupt (and not-so-abrupt) closures harm students and taxpayers alike. The Department continues to allow institutions to draw millions in funding each year, while failing to adequately oversee those institutions. And while the predatory behavior that has directly harmed students has been widely covered in the media and the courts, the focus on the impact to the federal fiscal interest—*i.e.*, preventing waste, fraud, and abuse of taxpayer funds—has received less attention. Yet the problems are real, and the consequences are immense. A recent Student Defense report highlights how the Department has failed to collect over $1 billion in debt owed to the government by institutions, instead prioritizing collections from individual borrowers who owe a miniscule percentage of that amount.[5] At the same time, the Department has completely forgone any use of its authority—also established as part of the 1992 reauthorization—to recoup financial losses from (and deter future misconduct by) individual wrongdoers.[6]

Importantly, the Department's financial responsibility tools and authorities are robust and not limited to accounting standards and the composite score. Rather, the HEA makes explicit that "financial responsibility" encompasses determinations regarding an institution's ability to meet the general financial responsibility standards ("Statutory General Standard") which assess whether—as a matter of "Financial Responsibility"— an institution can:

- Provide the services described in its official publications and statements;
- Provide the administrative resources necessary to comply with the requirements of Title IV; *and*
- Meet all financial obligations, including (but not limited to) refunds of institutional charges and repayments to the liabilities and debts incurred in programs administered by the Secretary.[7]

In practice, however, the Department's Financial Responsibility oversight has proven woefully insufficient. Even the most cursory review of recent trends identifies gaping failures. Consider:

- Institutions have been certified by the Department to participate in Title IV despite years of failing the Department's baseline "composite score" test.
  - At least eight institutions[8]—a mix of for-profit and non-profit— received a failing financial composite score *continuously* between 2006-07 and 2019-20 (the entire timespan of publicly released data).[9]
  - More than thirty other institutions have failed the composite score in each of the last five years for which data is available (Award year ("AY") 2015-16 through 2019-20).[10]
- Institutions that fail the Department's financial responsibility test continue to access government funding through the Title IV program, with minimal enhanced oversight and financial protection.
  - Walden University (through its then-corporate parent, Laureate Education, Inc.) posted failing composite scores *every year* (for which data is available) since AY 2009-2010.[11] During this time, Walden received billions in Title IV funds (including approximately $750 million in 2019-20 alone).[12] Although the Department held, in 2020, an $83 million surety from Laureate/Walden to guard against financial losses—itself a mere fraction of the total funding—even that amount reflected how "the Department [had] required Laureate to decrease its . . . letter of credit" in September 2020 by approximately $40 million from the previous academic year.[13]
  - Institutions under the Fortis/Education Affiliates brand have failed the Department's financial responsibility *every year* (for which data is available) since at least 2008-09. Despite these failures, in March 2021, and again in December 2021, the Department recertified certain Fortis schools for participation in Title IV. As of May 31, 2021, Department data indicated that Fortis owed more than $1,054,277 to the government,[14] but still received more than 140 times that amount ($147,783,621) in Title IV funds during AY 2020-2021.[15]
- Schools' financial failures often foreshadow their closures, and financial losses to student and taxpayers.[16] For example, Vatterott College failed the composite score

every year between 2006–07 and its collapse in 2018–2019. During this time, the Department failed to obtain adequate protection for financial loss from the institution to cover these losses, despite having abundant authority to do so. As of May 31, 2021, Vatterott still owed the Department more than $242 million. Likewise, the Art Institute of Pittsburgh closed in 2019, with at least one media outlet deeming it an "abrupt shutter[ing]."[17] Although many circumstances led to the ultimate closure, including a change-in-ownership, misconduct by the school and its executives, and the largest Title IV-related False Claims Act settlement in the history of the Justice Department, far less noticed is the school's failure of the Department's composite score test *continuously* between 2006-07 and 201718.[18]

- The HEA limits to three years the length of time the Department can permit a school to participate under a "provisional certification." Nevertheless, the Department interprets the statute in a way that eviscerates the statutory language and permits institutions with histories of financial responsibility failures to remain certified. In the case of Vatterott, the school collapsed after roughly *a decade* of provisional certification, leaving taxpayers on the hook for at least hundreds of millions of dollars. Similarly, Ashford University had been participating provisionally for nine years when the State of California sued it in 2017 for unlawful business practices.[19]

In 2021, with these oversight failures in the background, the Department announced its intent to form a negotiated rulemaking committee to revise its Financial Responsibility regulations.[20] As of the date of this Memorandum, the Department has released two sets of "issue papers" outlining potential changes to the Financial Responsibility regulations. Although the changes suggested in the issue papers generally support increased oversight, they do not reflect the urgency Congress encouraged 30 years ago to address problems that still persist today. Therefore, in consideration of the ongoing Rulemaking and the Department's obligation to periodically review regulations,[21] the Department must consider the issues discussed herein and amend the regulations accordingly.

Finally, because any changes adopted in the Rulemaking will not take effect until *at least* July 2023,[22] the Department must also reconsider its policies under existing regulations until new regulations take effect.

LEGAL FRAMEWORK

The Statutory Financial Responsibility Requirement

In addition to and "notwithstanding" the Statutory General Standard described above,[23] the HEA requires institutions to demonstrate financial responsibility by passing the Department's "composite score" test.[24] To implement this test, the Department has adopted metrics pursuant to which an institution can pass, fail, or temporarily be considered in a financial responsibility "zone."[25]

By statute, if an institution fails to meet both the Statutory General Standard and the composite score, the Department "shall" still consider it financially responsible if it complies with one of four permissive standards in HEA § 498(c)(3) ("the Permissive Standards"). These require an institution to either:

(A) submit a financial guarantee "not less than one-half of the annual potential liabilities of such institution . . . for funds under [Title IV], including loan obligations discharged pursuant to [20 U.S.C. § 1087] and to students for refunds of institutional charges";

(B) have "liabilities backed by the full faith and credit of a State";

(C) establish, "with the support of a financial statement audited by an independent certified public accountant in accordance with generally accepted auditing standards, that the institution has sufficient resources to ensure against the precipitous closure of the institution, including the ability to meet all of its financial obligations"; or

(D) meet "standards of financial responsibility, prescribed the Secretary by regulation, that indicates a level of financial strength not less than those required" by the composite score test.

With one inapplicable caveat,[26] the HEA provides no other means for an institution to demonstrate financial responsibility. A failure to be considered financially responsible renders an institution ineligible to participate in the Title IV programs.[27]

Regulatory Standards of Financial Responsibility

Consistent with the statutory standards, the Department's financial responsibility regulations[28] require that an institution "*must* demonstrate that it is financially responsible."[29] First, the institution must meet the Statutory General Standard, which is expressly incorporated into the Department's regulations.[30] Second, an institution must satisfy the four general regulatory standards (the "Regulatory General Standards"), which include the composite score.[31]

Notwithstanding these requirements, regulations allow institutions to participate in Title IV (under one of several modified conditions) without meeting the Regulatory General Standards. For institutions already participating in Title IV, these standards are: (i) the Financial Protection Alternative;[32] (ii) the Zone Alternative;[33] and (iii) two different Provisional Certification Alternatives (collectively "Provisional Certification Alternatives"), one of which is specifically designed for institutions controlled by individuals or entities owing liabilities to the Department.[34]

- Under the Financial Protection Alternative, 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 title IV, HEA program funds received by the institution during its most recently completed fiscal year."[35]
- Under the "Zone Alternative," an institution that is financially responsible solely because it had a composite score less than 1.5 (but more than 1.0) may participate for "no more than three consecutive years, beginning with the year in which the Secretary determines that the institution qualifies under this alternative."[36] Institutions participating in Title IV under the Zone Alternative are subject to additional oversight rules and disclosure standards.[37]
- Under the Provisional Certification Alternatives, an institution that does not satisfy the Regulatory General Standards or has hit a regulatory trigger limiting participation to provisional certification, may participate in Title IV under a "provisional" program participation agreement and must submit a letter of credit or other surety, "in an amount determined by the Secretary that is not less than 10 percent of the title IV, HEA program funds received by the institution during its most recently completed fiscal year."[38] By statute, provisional certification is limited to a period of three years.[39] However, regulations provide that the Department maintains the authority, "at the end of the period for which the Secretary provisionally certified the institution," to "again permit" an institution to participate under a provisional certification, even if the institution "is still not financially responsible."[40]

NECESSARY REFORMS

As written and applied, the Department's interpretation and application of the HEA's financial responsibility standards are problematic in two overarching respects. Although these failures have been part of the Department's regulations and practices for years, the Department must use the Rulemaking to come into compliance with the HEA's intent and statutory requirements.

1. BY ALLOWING INSTITUTIONS TO PARTICIPATE IN TITLE IV UNDER A PROVISIONAL CERTIFICATION FOR MORE THAN THREE YEARS, THE DEPARTMENT VIOLATES THE HEA.

Under HEA § 498(h), institutions are allowed to participate under provisional certification for no more than three years. Yet regulations governing provisional certification—both as written and applied—eviscerate this requirement. In practice, institutions have been routinely allowed to participate provisionally for more than three years, albeit through consecutive agreements, each of which is less than the statutory cap.

Not only is this practice contrary to law, but it is also costly. As noted above, Vatterott College closed after 12 years of financial responsibility composite score failures and at least nine years of provisional certification in excess of the statutory cap.[41] Remarkably, the school's closure was still described as "sudden[],"[42] "abrupt[],"[43] and caused by "mounting financial problems."[44] The cost to taxpayers was severe: two years after the closure, the Department determined that Vatterott's conduct cost taxpayers at least $242 million that remains uncollected.[45] Ashford University began participating under a provisional certification in 2008 following a composite score failure.[46] In November 2017, when the State of California sued Ashford for unlawful business practices, the school had been participating provisionally for nearly nine years.

The Department's policy of ignoring the three-year cap appears rooted in a 1994 interpretation that the Department will allow institutions that "have participated successfully under provisional certification, but who still do not satisfy certain requirements for full certification . . . to renew their provisional certification."[47] At the time, the Department did not believe that it needed specific regulatory language to authorize this interpretation, "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."[48]

But this rationale is, at best, unclear; the Department never indicated what it meant for a school to have "participated successfully." Nor did it explain how its interpretation complied with the statutory language or intent. In 1997, the Department enshrined this policy in regulations governing the Provisional Certification Alternatives. *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"). Nor did the Department attempt to square its interpretation with the notion that provisional certification is an *exception* to the general rule that schools *must* be financially responsible to participate in Title IV programs.

Instead, the Department's interpretation tacitly assumed that Congress intended to limit only the term of an individual certification, but not prohibit serial terms. But that reading ignores key textual evidence indicating that this was not what Congress intended. Specifically, when authorizing non-provisional (routine) certification, *i.e.*, where a period of renewal is the norm, Congress expressly referred to the possibility of "renewal."[49] But in the section regarding provisional certification, there is no reference to a "renewal," suggesting that three-years is the outermost limit on an institution's provisional certification.

The Department's regulations regarding the length of certification, and the application of those regulation permitting provisional certifications for longer than three years, are *ultra vires.* Accordingly, the Department should use the Rulemaking to:

(1) 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.

(2) 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, institutions that are still not financially responsible after the end of the provisional period would not be allowed to participate under either Provisional Certification Alternative. Consistent with the statute and existing regulations, such institutions would not be automatically removed from Title IV participation (although could be as a discretionary matter), but instead would need to qualify under a different standard such as the Financial Protection Alternative. In such a case—to mitigate the loss of enforcement flexibility[50] that accompanies the lack of provisional certification—the Department could shorten the length of any certification for institutions participating after the expiration of a provisional PPA. In such circumstances, 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.[51]

2. THE DEPARTMENT MUST REVISIT ITS LETTER OF CREDIT REGULATIONS TO ENSURE COMPLIANCE WITH THE HEA

As discussed above, the HEA provides that an institution failing the Statutory General Standard *and* the composite score test will 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 must be considered financially 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]." This guarantee—often in the form of a "Letter of Credit"— is designed to guard against taxpayer losses, for example, due to closed school loan discharges, false certification discharges, and refunds to students for other institutional charges.[52]

The Department has purported to mirror this alternative in its regulatory "Financial Protection Alternative" ("FPA"), described above. The Department has also imported the concept of the financial guarantee into other regulations, including the Provisional Certification Alternatives. In that case, 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.[53]

The Department must revisit these uses of financial guarantees.

(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 FPA purports to apply this language, it is materially different.

Statutory 50% Exception: HEA § 498(c)(3)(A)	Financial Protection Alternative: 34 C.F.R. § 668.175(c)
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."	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.**"

Whereas the statute requires such 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 "potential liabilities."

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. Had the Department held a surety representing 50% *of its prior year's Title IV draw*, that surety would have been approximately $43 million,[54] insufficient to protect taxpayers from the ultimate $242 million unpaid liability following the school's 2018 closure. (Vatterott was participating under the first Provisional Certification Alternative, not under the FPA, and, at the time of its closure, the Department held a surety representing 15% of the *prior year's Title IV draw*—resulting in an even greater deficit.[55]) By basing the surety amount on "annual potential liabilities"—and considering, for example, the multi-year source of closed school discharge liabilities—the Department could have mitigated these losses.

During the 1997 rulemaking establishing the FPA within Subpart L,[56] 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.[57] 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."[58] 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.[59]

And even more confusingly, in a different section of the regulations (regarding the waiver of the annual audit requirement), the Department interpreted the same "[50%] of the annual potential liabilities" language in the different section of the HEA to mean "*10 percent* of the amount of title IV, HEA program funds the institution disbursed to or on behalf of its students during the [preceding] award year."[60]

On their face, these conflicting interpretations are not reconcilable. But standing alone, neither is consistent with the statute. And from a *policy* perspective, the problem is clear: basing a surety solely on prior year 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. Accordingly, the Department must amend its FPA regulation to comply with the statute:

1. The Financial Protection Alternative must be based on *potential liabilities*, as determined by the Department, not simply on a school's prior year's Title IV draw; and
2. The surety requirement in the Financial Protection Alternative must be based on all "annual potential liabilities," *i.e.*, liabilities an institution is exposed to in a given year. 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. That standard imposes a requirement that institutions post a surety of a minimum of 10% of the prior year's Title IV funding.

Apart from the 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)."[61] 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 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*."[62] 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.[63] 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 during the institution's period of provisional certification."[64] 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).

CONCLUSION

At present, the Department's regulations do not comport with the Higher Education Act in numerous respects. Accordingly, Student Defense strongly urges the Department to expand its consideration of Financial Responsibility in the Rulemaking to consider the issues raised herein. The Department cannot continue to promulgate and operate under regulations that are contrary to the HEA or plainly inadequate to protect student and taxpayer interests. The Department must:

- Enforce the statutory, three-year limit on provisional certification, requiring institutions that continue to participate to satisfy financial responsibility standards;
- Ensure that the amount of any surety provided under the Financial Protection Alternative is tailored to cover all "annual potential liabilities," rather than simply be based on a percentage of the prior year's Title IV funding;
- Revamp its surety requirements for schools participating provisionally, to ensure that students and taxpayers have adequate financial protection in the event of a closure.

APPENDIX A

REGULATORY ALTERNATIVE STANDARDS 34 C.F.R. § 668.175		
Alternative	Used When	Provisions
Financial Protection Alternative (Participating Institutions) ("FPA") 34 C.F.R. § 668.175(c)	Currently participating institution that does not satisfy general standards of financial responsibility (including composite score) or because auditor expresses a qualified, adverse, or disclaimed opinion or doubt about the continued existence of the institution as a going concern.	The institution may continue to participate as financially responsible by submitting a surety for at least 50 percent of Title IV funding received during the institution's most recently completed fiscal year. Does not apply to public institution.
Zone Alternative 34 C.F.R. § 668.175(d)	Currently participating institution that is not financially responsible solely because its composite score is less than 1.5, but is greater than 1.0.	The institution may continue to participate as financially responsible, but must: do so under the heightened cash monitoring or reimbursement methods of payment; provide information regarding certain oversight and financial events to the Department in a timely manner; and be potentially subject to increased auditing and oversight requirements. Cannot be used for more than 3 consecutive years.
Provisional Certification Alternative 34 C.F.R. § 668.175(f)	Currently participating institution that does not satisfy general standards of financial responsibility (including composite score), its recalculated composite score is less than 1.0, is subject to a mandatory triggering event or a discretionary triggering event that has an adverse material effect , or because auditor expresses a qualified, adverse, or disclaimed opinion or doubt about the continued existence of the institution as a going concern.	The institution may participate under a provisional certification by submitting a letter of credit for at least 10 percent of Title IV funds received during its most recent fiscal year; institution must also show current on all debt payments and meeting all financial obligations. Institution must meet requirements of Zone alternative. Regulation presumes that the PCA will not be used for more than three years, but gives Secretary authority to "again permit the institution to participate under a provisional certification."

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REGULATORY ALTERNATIVE STANDARDS 34 C.F.R. § 668.175		
Alternative	Used When	Provisions
Provisional Certification Alternative for Persons or Entities Owing Liabilities 34 C.F.R. § 668.175(g)	Institution is not financially responsible because the persons or entitles that exercise substantial control over the institution owe a liability for a violation of a Title IV program requirement. The institution must also meet all other standards of financial responsibility under 668.171(b) (including the composite score)	The persons or entities that exercise substantial control must enter into an agreement to repay the applicable portion of the liability or the institution assumes the repayment obligation and enters into an agreement to repay (or repays). The institution must submit a 10 percent of Title IV funds received during its most recent fiscal year; institution must also show current on all debt payments and meeting all financial obligations. Institution must meet requirements of Zone alternative. The Secretary has specific authority to require personal guarantees or require joint and several liability.

Endnotes

1 Permanent Subcomm. on Investigations of the Comm. on Gov. Affairs, U.S. Sen., Abuses in Fed. Student Aid Programs, S. Rep. No. 102-58 at 11 (1991).

2 Hearings on the Reauthorization of the Higher Educ. Act of 1965: Program Integrity Before the Subcomm. On Postsecondary Educ. of the Comm. Of Educ. and Labor, 102nd Cong. 136 (May 1991) (Testimony of Elizabeth Innols, Esq., Consumer Law Coordinator, Legal Services for New York City, South Brooklyn Legal Services, citing Educ. Inspector General Audit, Financial Analysis Certification Process Not Adequate to Protect Students and Government, Control No. 11-80160 (Sept. 1990)).

3 For example, at the hearings, the President of the American Council on Education testified that: "Lax administration of Title IV programs which annually distribute some $20 billion in student assistance has led to widely-reported instances of fraud and abuse, particularly in short-term occupational programs which enroll a high proportion of low-income, high-risk students. Such instances have eroded public confidence in the programs, although most institutions do a responsible job of managing federal funds." Hearings on the Reauthorization of the Higher Education Act of 1965: Program Integrity Before the Subcomm. On Postsecondary Educ. of the Comm. Of Educ. and Labor, 102nd Cong. 94 (May 1991) (Testimony of Robert H. Atwell, President, American Council on Educ.).

The Department's Inspector General agreed, explaining to Congress that its "reviews of the Department's process for certifying schools as administratively capable and financially responsible disclosed that these processes did not prevent deficient schools from Title IV participation and did not assure that students and the Government were protected when schools failed before providing all educational services due." H.R. Rep. No. 102-447 at 75 (1992), *as reprinted in* 1992 U.S.C.C.A.N. 334.

4 H.R. Rep. No. 102-447 at 10 (1992), *as reprinted in* 1992 U.S.C.C.A.N. 334.

5 *See* Daniel Zibel, Aaron Ament, & Kirin Jessel, Student Defense, *The Missing Billion*: *The U.S. Department of Education Aggressively Pursues Financially Distressed Student Borrowers while Letting Colleges and Executives Walk Away from More than A Billion in Unpaid Debt* (June 2021), *available at*: https://www.defendstudents.org/news/body/NSLDN_paper_Missing_Billion.pdf

6 *See generally* Daniel Zibel & Alice Yao, Student Defense, *Protection and the Unseen: Holding Executives Personally Liable under the Higher Education Act* (Oct. 2020), *available at*: https://www.defendstudents.org/news/body/docket/100-Day-Docket-Personal-Liability-Report.pdf

7 *See* HEA § 498(c)(1)(A)–(C), 20 U.S.C. § 1099c(c)(1)(A)–(C).

8 In this report, we define "institution" at the 8-digit OPEID level.

9 These schools are: The Academy of Natural Therapy, The French Culinary Institute, MTTI-WellSpring Center for Natural Health & Wellness, Ohio Valley University, Research Medical Center, Rochester College, Southside Regional Medical Center Professional Schools and the Tai Sophia Institute. U.S. Dep't of Educ., Fed. Student Aid, Financial Responsibility Composite Scores, https://studentaid.gov/datacenter/school/composite-scores [hereinafter FSA Composite Scores].

10 The following 31 schools failed *every year* from Academic Year ("AY") 2014-2015 through 2018-2019: Academy of Radio & TV Broadcasting, Claremont School of Theology, Northcentral University, TUI University, Trinity Vocational Center, Unitek College, Academy of Natural Therapy, Florida School of Traditional Midwifery, Southwest Florida College, Southern Technical College, Iowa Wesleyan College, University of Saint Mary of the Lake, Blue Cliff College, Medix School (Fortis), Tai Sophia Institute, Rochester College, Evangel University, Research Medical Center, MTTI-WellSpring Center for Natural Health & Wellness, Crouse Hospital School of Nursing, French Culinary Institute, The Joffrey Ballet School, American Ballet Center, Saint Elizabeth Medical Center, Sotheby's Institute of Art – NY, Spartan College of Aeronautics and Technology, Baptist Bible College of Pennsylvania, Keystone College, Roxborough Memorial Hospital, Southside Regional Medical Center Professional Schools, Ohio Valley University, Walden University. *Id.*

11 FSA Composite Scores, *supra* note 9. Note that during certain of these years, Walden University's composite score was reported only under (and as part of) Kendall College, also owned by Laureate. *See generally* U.S. Gov't Accountability Office, *Education Should Address Oversight and Communication Gaps in its Monitoring of the Financial Condition of Schools*, GAO 17-555, at 27 (August 2017), *available at*: https://www.gao.gov/assets/690/687225.pdf.

12 U.S. Dep't of Educ., Fed. Student Aid, Direct Loan Volume by School, https://studentaid.gov/data-center/student/ title-iv [hereinafter FSA Direct Loan Volume]; U.S. Dep't of Educ., Fed. Student Aid, Financial Responsibility Standards Requiring a Letter of Credit, https://studentaid.gov/data-center/school/loc [hereinafter FSA LOC Requests].

13 U.S. Dep't of Educ. FOIA # 21-02118-F (Sep. 2021), providing data on letters of credit held by the U.S. Dep't of Educ. as of July 2020 (on file with Student Defense); Laureate Educ., Inc., Annual Report (Form 10- K) (Feb. 25, 2021), *available at*: https://www.sec.gov/ix?doc=/Archives/edgar/data/912766/000162828021003163/laur-20201231.htm

14 U.S. Dep't of Educ. FOIA # 21-02015-F (Aug. 2021), providing data on unpaid liabilities owed to the U.S. Dep't of Educ. as of May 31, 2021. On file with Student Defense.

15 FSA Direct Loan Volume, *supra* note 12.

16 *See, e.g.*, Robert Kelchen, Brookings Inst., *Examining the feasibility of empirically predicting college closures* (Nov. 2020), *available at*: https://www.brookings.edu/wp-content/uploads/2020/11/ES-11.23.20-Kelchen.pdf ("Poor performances on federal accountability measures, such as the cohort default rate, financial responsibility metric, and being placed on the most stringent level of Heightened Cash Monitoring, were frequently associated with a higher likelihood of closure.").

17 Sarah Boden, *Art Institute of Pittsburgh Abruptly Shutters*, 90.5 WESA, March 9, 2019, *available at:* https://www.wesa.fm/education/2019-03-09/art-institute-of-pittsburgh-abruptly-shutters

18 FSA Composite Scores, *supra* note 9.

19 According to filings with the Securities and Exchange Commission, the Department of Education provisionally certified Ashford University in December 2008, to expire on June 30, 2011. *See* Bridgepoint Education, Inc., Annual Report (Form 10-K) (March 2, 2010). According to the 10-Ks for the year ending 2011 and 2012, Ashford remained provisionally certified after that date, while the Department considered its reapplication. *See* Bridgepoint Education, Inc., Annual Report (Form 10-K) (March 6, 2012); Bridgepoint Education, Inc., Annual Report (Form 10-K) (March 12, 2013). In the 10-K for the following year, Ashford stated that they were provisionally certified until September 30, 2016. Bridgepoint Education, Inc., Annual Report (Form 10-K) (March 17, 2014). And in the 10-K for the year ending December 2017, Bridgepoint reported that Ashford's provisional certification was to last until December 2018. Bridgepoint Education, Inc., Annual Report (Form 10-K) (February 21, 2018). That provisional PPA was subsequently extended until March 31, 2021. Bridgepoint Education, Inc., Annual Report (Form 10-K) (March 12, 2019).

20 Negotiated Rulemaking Comm.; Negotiator Nominations and Schedule of Comm. Meetings, 86 Fed. Reg. 69,607 (Dec. 8, 2021) (Docket ID ED-2021-OPE-0077).

21 Regulations must be periodically reviewed and modernized. Section 5 of Executive Order 12,866 requires the Department to develop a program to "periodically review its existing significant regulations to determine whether any such regulations should be modified or eliminated so as to make the agency's regulatory program more effective in achieving the regulatory objectives, less burdensome, or in greater alignment with the President's priorities and the principles." Exec. Order No. 12,866 also provides that "significant regulations selected for review shall be included in the agency's annual Plan," and that the "agency shall also identify any legislative mandates to promulgate or continue to impose regulations that the agency believes are unnecessary or outdated by reason of changed circumstances." Similarly, under Exec. Order No. 13,563 § 6(b), the Department must submit to OIRA a plan to "periodically review its

existing regulations [...]". President Biden issued a memorandum on "Modernizing Regulatory Review" that reaffirmed both Exec. Orders Nos. 12,866 and 13,563.

Congress has also mandated that agencies conduct periodic reviews of their regulations. For example, the Foundations for Evidence-Based Policymaking Act of 2018 (FEBPA) directs agencies to develop "a systematic plan for identifying and addressing policy questions relevant to the programs, policies, and regulations of the agency." Pub. L. No. 115-435, 132 Stat 5529 (2019); Memorandum M-19-23*, Phase 1 Implementation of the Foundations for Evidence-Based Policymaking Act of 2018: Learning Agendas, Personnel, and Planning* Guidance (July 10, 2019), *available at:* https://www.whitehouse.gov/wp-content/uploads/2019/07/M-19-23.pdf.

22 The Department's current "Unified Agenda" projects that the Department will not issue a Notice of Proposed Rulemaking until July 2022, making it highly unlikely that the Department will complete the rulemaking process in time for the rules to take effect before July 1, 2024.

23 HEA § 498(c)(1), 20 U.S.C. § 1099c(c)(1).

24 HEA § 498(c)(2), 20 U.S.C. § 1099c(c)(2); *see also* 34 C.F.R. § 668.172.

25 *See generally* 34 C.F.R. § 668.171(b)(1), 34 C.F.R. § 668.172, 34 C.F.R. § 668.175(d).

26 If an institution "provides a 2-year or 4-year program of instruction for which the institution awards an associates or baccalaureate degree," and fails the composite score and the Permissive Standards, the Secretary "shall waive" the composite score requirement if the institution demonstrates that: (a) there is "no reasonable doubt" as to an institution's "continued solvency"; and (b) the institution is "current in its payment of all current liabilities, including student refunds, repayments to the Secretary, payroll, and payment of trade creditors and withholding taxes"; and (c) the institution has "substantial equity in school-occupied facilities, the acquisition of which was the direct cause of its failure to meet the criteria." HEA § 498(c)(4), 20 U.S.C. § 1099c(c)(4).

27 HEA § 498(a), 20 U.S.C. § 1099c(a); *see also* 34 C.F.R. § 668.171(a).

28 There are currently two discrete sets of regulations governing financial responsibility: 34 C.F.R. § 668.15 and 34 C.F.R. Part 668 Subpart L. Both provide substantive standards for financial responsibility, and therefore, Title IV eligibility. The Department uses the section 668.15 factors "when it is notified of an institution's change in ownership or control," while using the standards in Subpart L for schools with ongoing participation. *See* 85 Fed. Reg. 18638, 18665. In the Rulemaking, the Department has proposed to clarify the distinction between the two sections, by reserving 34 C.F.R. § 668.15 and modifying Subpart L accordingly. Student Defense supports clarifying the regulations in this regard.

29 34 C.F.R. § 668.171(a) (emphasis added).

30 *See id.* § 668.171(a)(1)–(3).

31 *Id.* § 668.171(b). Finally, the Department's regulations include a variety of circumstances (known as "mandatory triggering events" and "discretionary triggering events") which can lead an otherwise financially responsible institution to be deemed unable "to meet its financial or administrative obligations," and thus be not financially responsible under the Regulatory General Standards. *See id.* §§ 668.175(c)–(d).

32 *Id.* § 668.175(c)

33 *Id.* § 668.175(d)

34 *Id.* § 668.175(f)–(g).

35 *Id.* § 668.175(c). Note, this requirement "does not apply to a public institution." *Id.*

36 *Id.* § 668.175(d)(1).

37 *Id.* § 668.175(d)(2).

38 *Id.* § 668.175(f)(2)(i). Under the PCA an institution must also demonstrate that they are current on all debt payments and comply with enhanced notification and oversight requirements. *Id.* § 668.175(f)(2)(ii)–(iii).

39 *Id.* § 668.175(f)(1)

40 *Id.* § 668.175(f)(3). Regulations governing the Provisional Certification Alternative for persons or entities owing liabilities do not include this language. That form of provisional certification does, however, require that the person or entities that owe the liability and substantially control the institution repay or enter into a repayment agreement with the Department. In the alternative, the institution itself can assume the liability and repay, or enter into an agreement to repay, the liabilities. *See generally id.* § 668.175(g).

41 U.S. Dep't of Educ. FOIA # 20-00949-F. (Oct. 2020), providing copies of Vatterott program participation agreements. On file with Student Defense.

42 *Vatterott College system closes all 15 campuses,* Associated Press, Dec. 18, 2018, *available at:* https://apnews.com/article/us-news-education-st-louis-us-department-of-education-71a07fb863bf4e459a7f1c2417cb1ecd.

43 *Vatterott College abruptly shuts down, including St. Louis area locations,* KMOV.com, Dec. 17, 2018, *available at:* https://www.kmov.com/news/vatterott-college-abruptly-shuts-down-including-st-louis-area-locations/article_6addb572-024d-11e9-b127-3fb1ac6cae9e.html.

44 *Vatterott College system closes all 15 campuses*, *supra* note 42.

45 As reported by the Department, in records obtained through FOIA as of May 31, 2021*, supra* note 14. Student Defense has submitted numerous request for more recent information; the Department has yet to respond (FOIA Nos. 22-01568-F & 22-01861-F).

46 *See supra* note 19.

47 59 Fed. Reg. 22348-01, 22371 (April 29, 1994).

48 *Id.*

49 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 Bhd. 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.").

50 Institutions participating provisionally can be subject to *immediate* loss of Title IV eligibility. *See* 34 C.F.R. § 668.13(d)(1)–(2) (affording the Secretary authority to "revoke" a provisional certification, effective upon mailing of a notice, upon a determination that "the institution is unable to meet its responsibilities under its program participation agreement"). In contrast, a non-provisionally certified institution during the term of its participation is generally afforded the benefit of an administrative hearing before any enforcement action can be brought. *See generally* 34 C.F.R. Part 668 Subpart G.

51 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 would 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.

52 HEA § 498(c)(3)(A), 20 U.S.C. § 1099c(c)(3)(A).

53 34 C.F.R. § 668.175(f)(2)(i); 34 C.F.R. § 668.175(g)(1)(iii).

54 The 15% surety totaled $12,882,632. Assuming this figure represented 15% of the Title IV draw, the total Title IV draw would have been approximately $85 million.

55 FSA LOC Requests, *supra* note 12.

56 Between 1994 and 1997, the precursor to the Financial Protection Alternative was found in 34 C.F.R. § 668.15(d)(2)(i).

57 Student Assistance General Provisions, 62 Fed. Reg. 62830-01, 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.")

When the Department first proposed the 1994 version of the financial protection alternative, *see supra* note 56, 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).

58 *Id.*

59 Leading up to the 1992 Reauthorization, both the Nunn Committee and the Department's Inspector General highlighted substantial losses to taxpayers that resulted from minimal surety arrangements. *See* Permanent Subcomm. on Investigations of the Comm. on Gov. Affairs, U.S. Sen., Abuses in Fed. Student Aid Programs, S. Rep. No. 102-58 at 26 (1991); Hearings on the Reauthorization of the Higher Education Act of 1965: Program Integrity Before the Subcomm. On Postsecondary Educ. of the Comm. Of Educ. and Labor, 102nd Cong. 277 (May 1991) (Testimony of James B. Thomas, Jr. Inspector General, U.S. Dep't. of Educ.).

In crafting the legislation, Congress made clear that the financial protection was to be based on *potential liabilities.* Congress could have—but did not—tie the extent of the financial protection to the prior year's Title IV funding. Moreover, during the process, Congress reduced the extent of the protection required from *all* potential liabilities to *half* of potential liabilities. *See* H.R. Rep. No. 3553 (1992). But Congress was steadfast in tying the amount of the protection to "potential liabilities," rather than prior year Title IV draws.

60 *Compare* HEA § 487(c)(1)(A)(iii), 20 U.S.C. § 1094(c)(1)(A)(iii) *with* 34 C.F.R. § 668.27(c)(9)-(d). *See also* Institutional Eligibility Under the Higher Education Act of 1965, as Amended and Student Assistance General Provisions, Notice of Proposed Rulemaking, 64 Fed. Reg. 38,272, 38275 (July 15, 1999) (describing how a negotiated rulemaking committee "concluded" that "a letter of credit in an amount equal to 10 percent of an institution's Title IV, HEA programs disbursements for an award year was the appropriate amount to satisfy" the statutory requirement that the letter of credit equal 50 percent of "annual potential liability").

61 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.

62 59 Fed. Reg. 9526-01, *9535, 1994 WL 57482 (Feb. 28, 1994) (emphasis added).

63 *Motor Vehicle Manufacturers Association v. State Farm Auto Mutual Insurance Co*, 463 U.S. 29, 43 (1963).

64 59 Fed. Reg. 9526-01, *9535, 1994 WL 57482 (Feb. 28, 1994) *adopted* 59 Fed. Reg. 22348 (Apr. 29, 1994).

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