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Borrower Defense to Repayment

How this New Rule Could Impact your Institution

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Borrower Defense to Repayment (BDTR)

- Loan discharges
- Existing BDTR statute and regulation
- Negotiated Rulemaking
- Proposed Rule
- Potential Impact

What is a “closed school discharge?”

- Borrower defense provision is completely separate from the closed school discharge (“CSD”) option.
- Students affected by their institution’s closure may seek loan discharge under certain circumstances based on timing and willingness to forego transfer credit.
- Claim does not require any confirmation of wrongdoing by the institution.
- As of June 24, 2016, the Department has processed 7,386 CSD claims for Corinthian students comprising \$97,613,625 in loan relief.
- In California, students also have access to STRF funds.

Other forms of loan discharge

- False Certification of Student Eligibility or Unauthorized Payment
 - school falsely certifies student eligibility to receive a loan based on ability to benefit (ATB) from its training
 - the proposed rule shifts away from ATB to focus on falsified high school graduation status or documentation
 - school falsified student signature on application, promissory note, loan check or signs an authorization for electronic funds transfer
 - student was a victim of identity theft
 - school certifies eligibility, but because of some condition, student is disqualified from employment in the occupation in which s/he was being trained
- Unpaid Refund Discharge
 - school doesn't pay a refund that it owed to the ED. (Discharge of unpaid refund amount only.)

Other forms of discharge addressed in the proposed rule

- Proposed rule requires that closing institutions, ED and loan holders conduct more robust notification to affected borrowers, to ensure they are aware of the options if institution closes, including forbearance on collection during application process.
- False certification discharge can now be provided by ED without an application based on information in ED's possession, including, but not limited to, falsification of Satisfactory Academic Progress.
- False certification relating to high school diplomas is now based on:
 - the institution falsifies the borrower's status as graduated
 - the institution, or a third party to which the school referred the borrower, falsifies the borrower's graduation documents

Basis for BDTR statute

- BDTR is rooted in the creation of the Direct Loan (DL) program.
- The statute and implementing regulations apply to **all institutions that participate in the DL programs.**
- BDTR is not available to borrowers under FFELP.
 - Proposed rule allows BDTR option for those who consolidate FFELP loans into a DL consolidation product.

The BDTR statute

- Statutory language in **20 USC §1087e(h)**, passed in 1994:
Borrower defenses
Notwithstanding any other provision of State or Federal law, the Secretary shall specify in regulations which acts or omissions of an institution of higher education a borrower may assert as a defense to repayment of a loan made under this part, except that in no event may a borrower recover from the Secretary, in any action arising from or relating to a loan made under this part, an amount in excess of the amount such borrower has repaid on such loan.
- Required regulations to define “acts or omissions,” but the Department did not actually define those terms. Instead, regulations created processes and added language around seeking recourse against an institution if a defense is granted.
- Between 1995 and 2015, ED states only **five** claims for a BDTR had been made.

Current BDTR regulatory language (in pertinent part)

34 CFR §685.206(c). Borrower defenses.

(1) *In any proceeding to collect on a Direct Loan, the borrower may assert as a defense against repayment, **any act or omission of the school** attended by the student **that would give rise to a cause of action against the school under applicable State law** [...]*

(2) *If the borrower's defense against repayment is successful, the Secretary notifies the borrower that the borrower is relieved of the obligation to repay all or part of the loan and associated costs and fees that the borrower would otherwise be obligated to pay. The Secretary affords the borrower such further relief as the Secretary determines is appropriate under the circumstances [...]*

(3) *The Secretary may initiate an appropriate proceeding to require the school whose act or omission resulted in the borrower's successful defense against repayment of a Direct Loan to pay to the Secretary the amount of the loan to which the defense applies. However, the Secretary does not initiate such a proceeding after the period for the retention of records described in § 685.309(c) unless the school received actual notice of the claim during that period.*

Federal Register notices on BDTR in 2015

- June 10, 2015: focused on collecting data that would assist the Department to aid in preserving borrowers' rights and to adjudicate requests for relief
- August 20, 2015: announced ED's intent to coordinate a Negotiated Rulemaking panel in January 2016 to finally define the "acts or omissions"
- October and December 2015: calls for negotiators to present 14 "constituencies" on the rulemaking panel

ED activity around BDTR

- Due to the impact of the Corinthian closure and the influx of claims, ED appointed a “Special Master”
- ED created new forms specifically for students of Heald, intended to fast track their claims
- As of June 2016, ED had received more than 26,000 applications amounting to requests for relief for more than \$200M in student loans (more than 85% were from Corinthian students)
- Of those claims, almost 10,000 came from California
- As of June, ED has authorized defense to repayment relief of \$73,110,502 relating to 3,787 Corinthian borrowers

BDTR – Notices of Proposed Rulemaking (NPRM)

- NPRM called for hearings on BDTR prior to negotiations
- Rulemaking sessions in January, February and March 2016
- Topics far beyond defining the “acts and omissions” required for a BDTR claim
 - Levels of involvement and liability of institutions in the BDTR process
 - Limitations to student recovery
 - Financial responsibility of institutions (including new triggers and letters of credit)
 - Updates to False Certification Discharges
 - Consolidation of nursing program loans
 - Technical changes to Pay as You Earn (PAYE) program
 - Revisions to other discharge rules

The negotiators

- Borrower advocates
 - veteran/military representatives
 - public interest law groups
 - Attorneys General
 - student representative (Corinthian)
- Institutional representatives
 - traditional/non-profit
 - state colleges/universities
 - community colleges
 - HBCUs
 - for-profit
- Guaranty agencies/loan servicers

The negotiations

- Multiple iterations of each rule that were changed during negotiations with little time to review before discussing
- Appearances by Senator Elizabeth Warren and Rep. Maxine Waters
- Demands to extend to four sessions because negotiators felt like there was insufficient time to review and discuss
- ED did not, and claimed they could not, provide a financial impact analysis on the DL program if BDTR is substantially broadened
 - what is the total cost to US Treasury of broadly discharging federal student loans?
 - could the cost impact the overall health of the loan programs?
- No consensus

NPRM –proposed rule issued

- NPRM officially released in the Federal Register¹ on June 16, 2016
- Comment period of 45 days – comments had to be submitted on or before August 1, 2016
- More than 10,000 comments were submitted
- A number of non-profit colleges/universities and associations that work with the NFP sector commented negatively about aspects of the proposed rule

¹Federal Register /Vol. 81, No. 116 /Thursday, June 16, 2016 / Proposed Rules

NPRM – the proposed rule

- A “borrower defense” is an “act or omission of the that relates to the making of a Direct Loan for enrollment at the school or the provision of educational services for which the loan was provided”
- New federal standards for “acts and omissions”
- Process for individual and group claims for BDTR
- ED makes final determination whether to grant loan relief – and how much. Not assumed to be a full discharge.

NPRM – the proposed rule

- Role of institution and ED
 - proposed rule is vague on the process by which institutions are notified and given the chance to respond to BDTR claims filed against them in “fact finding process”
 - ED will determine whether a group claim exists, and will represent that group, in front of an ED hearing officer
 - ED will determine the amount of relief for the student/group
 - ED will attribute any loan debts it forgives back to the institution as a liability
 - either party may appeal ED’s decision within 30 days
 - borrowers can request reconsideration at any time

New federal standard for “acts or omissions”

- Breach of contract between school and student
 - if institution failed to perform its obligations under a contract with the borrower, s/he may assert this claim at any time
 - for claims to recover amounts previously paid to ED, no later than six years after the breach
- “Contested judgement” against the school
 - whether as an individual or as a member of a class, or a governmental agency, has obtained against the school a non-default, favorable contested judgment based on State or Federal law in a court or administrative tribunal of competent jurisdiction
 - no statute of limitations on this type of claim

New federal standard for “acts or omissions”

- Substantial misrepresentation
 - amends existing regulations on misrepresentation (§ 668.71):
 - removing any element of intent (“to deceive”) and shifts to “misleading under the circumstances”
 - adds “any statement that omits information in such a way as to make the statement false, erroneous, or misleading.”
 - includes institutional tactics that ED will consider as evidence of reasonable reliance by borrower
 - borrower may claim this at any time, and may assert a claim under this section to recover funds previously paid to ED not later than six years after the borrower discovers, or reasonably could have discovered, the substantial misrepresentation

NPRM – proposed rule – financial responsibility

- New financial responsibility rules
 - creates automatic triggers indicating an institution is not financially responsible
 - places school in provisional status and requires “zone alternative” measures
 - requires institution to post a Letter of Credit (LOC) for at least 10% of the amount of title IV, HEA program funds received by the school during the most recently completed award year
 - LOCs are cumulative. EACH event triggers an additional LOC.

NPRM – proposed rule – financial responsibility

- **Automatic** triggers include (but are not limited to):
 - “excessive” borrower defense claims where the school owes money back to ED (now or in the past three years)
 - “excessive” liabilities that are owed to state or federal agencies (now or in the past three years)
 - includes audits, investigations or similar actions (i.e. program review liabilities)
 - currently being sued where the claim exceeds 10% of the school’s current assets
 - by a state, federal or other agency for borrower defense issues (floor is \$750,000 for these claims)
 - by state, federal or other agency for “claims of any kind”
 - under the False Claims Act (qui tam)
 - by private parties for claims relating to the making of loans or provision of educational services

NPRM – proposed rule – financial responsibility

- What is “excessive” debt or liabilities?
 - currently defined as “exceeds the lesser of the threshold amount for which an audit is required under 2 CFR Part 200, or 10 percent of its current assets, as reported in the most recent audited financial statements submitted by the institution to the Secretary.”
 - 2 CFR 200 currently lists \$750,000 as the threshold for audit.

NPRM – proposed rule – financial responsibility

- **Automatic** triggers include (but are not limited to):
 - accretor actions - current or in the last three years including:
 - being placed on probation
 - issued a show cause order
 - placed on any status that poses an equivalent risk to the institution's accreditation
 - being required to submit a teach-out plan due to:
 - emergency action by ED
 - accretor action to withdraw, terminate or suspend accreditation
 - institutional plans to cease operations
 - state authorizing action to revoke approval

NPRM – proposed rule – financial responsibility

- **Automatic** triggers include (but are not limited to):
 - cohort default rates over 30% for two most recent years
 - violation of 90/10 in the most recently completed award year
 - violation of loan agreements and obligations with primary lender
 - failing GE programs account for more than 50% of school's enrolled students
 - withdrawal of owner equity if composite score is less than 1.5
 - for publicly traded schools – SEC “warning” that it might suspend trading on the school's stock; disclosure by the school of a legal or administrative proceeding; failure to file annual or quarterly reports or notification by the exchange that school is out of compliance

NPRM – proposed rule – financial responsibility

- ED may determine that “other events or conditions” are reasonably likely to adversely affect an institution’s financial condition which could result in a LOC(including but not limited to):
 - “significant fluctuations” in Title IV funds that the school receives from one year to the next that can’t be “accounted for” by program changes
 - citation by a state agency that the school has violated a state rule or regulation
 - high dropout rates at the school, based on ED’s calculation

Other important elements of the proposed rule

- Prohibition on obtaining or attempting to enforce a waiver of or ban on class action lawsuits regarding borrower defense-type claims
- Prohibition on compelling the borrower to enter into a pre-dispute agreement to arbitration of a borrower defense-type claim, or attempt to compel a borrower to arbitrate such a claim by virtue of an existing a pre-dispute arbitration agreement
 - both of these bans are retroactively applied
- Disclosure of “failing” repayment rates (applies to for-profit schools only)

Potential Impact

➤ Operational

- changes to student agreements, processes and policies
- heightened risk associated with misrepresentation
- defend against BDTR claims

➤ Financial

- access to letters of credit, especially problematic if multiple triggers are hit
- potential liabilities for BDTR claims

What's next?

- ED FAQ on proposed rule:
<http://www2.ed.gov/policy/highered/reg/hearulemaking/2016/bd-faq2016.pdf>
- Final rule must be published in the Federal Register before November 1, 2016 to take effect on July 1, 2017, only affecting loans made after that date.
- Proposed rule is currently at OMB (Office of Management and Budget) – there is a short window where they are accepting meeting requests to discuss the proposal.

Further information:

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