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ED Adds New Letter of Credit Requirements to Student Loan Negotiations

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The US Department of Education and appointed negotiators representing higher education and legal groups are preparing for the second round of negotiations to expand the "Borrower Defense to Repayment" regulations, with the next session to run from Wednesday, February 17 through Friday, February 19. During the second round, negotiators will begin substantive discussions of the key regulatory issues that will determine whether this rule has the massive impact some proponents are pushing for. These include (1) the legal standard student claimants must meet to prevail in a claim, (2) the extent to which ED will review groups of claims (somewhat like a class action) or require students to back up their claims with individualized evidence, (3) the extent to which institutions will be able to contest claims, and (4) the tools ED may employ to recover funds from institutions for loans that are essentially forgiven under the "BDR" provision.

ED has just circulated its new position papers to address these and other issues to be discussed this week, and ED has greatly expanded the scope of the rulemaking with a new proposal to require institutions to post a letter of credit ("LOC") in advance in certain circumstances to ensure their ability to pay BDR claims. ED has identified approximately 20 mandatory or discretionary triggers for such an LOC, including failure to make refunds, violation of a loan agreement, requirement to repay student aid funds arising from audits or compliance reviews, show-cause action by an accrediting body, de-listing of the stock of a publicly traded company, being sued by a federal or state regulatory body, having a significant number of pending BDR claims, and others. This is a sweeping list of potential triggers and new authority for ED to use one of its tools under the financial responsibility regulations to strengthen enforcement in other areas.

Political and budgetary background

The BDR regulation will apply to all institutions in all sectors – public, non-profit or proprietary – and these sectors have 5 of the 15 seats at the table, with the proprietary sector getting a single seat. ED also selected 5 negotiators to represent state attorneys general, consumer law groups, student advocates and veterans groups that will generally argue for a broad rule. While some negotiators seem to view this as a way to "rein in the for-profits," we are hearing anxious rumblings from "traditional" institutions that will be subject to the same rule and are concerned about the impact of broadening the claims available to their students and graduates, which could result in institutional liabilities.

We believe it is inevitable that the budgetary impact of this new regulation will become an important factor in the negotiations. As noted below, ED already is processing claims valued at more than $164 million in loan funds and, based on the positions being advanced by some negotiators, they will aim for a rule that opens the doors to claims totaling many additional hundreds of millions of dollars. At some point, the Office of Management and Budget has to take an interest in a regulation that could lead to such sweeping loan forgiveness and costs to the Federal Treasury. Of course, this factor may also be a source of pressure for ED to broaden its powers to recover from the institutions that are the subject of the BDR claims.

Legal standard for borrower claims

The current regulations require a borrower to present evidence that a school acted, or failed to act, in a way that could "give rise to" a state law claim without stating an evidentiary standard to assess such claims. The negotiators are considering whether the new regulation should include a federal standard or should continue to rely exclusively on state consumer protection laws, or incorporate both.

The Department suggested potential options for a federal standard, including its misrepresentation regulations,[1] breach of contract, or the unfair practices standards used by the Federal Trade Commission and the Consumer Financial Protection Bureau. Some negotiators argued that intent is crucial in these cases and therefore a finding of misrepresentation alone should not support a BDR claim without evidence of *intent* to mislead or harm the student.

More fundamental is the question of what standard of proof and injury the new rule will require. The current regulation simply requires the student to establish an act or omission by an institution that would "give rise to a cause of action" against the school under applicable state law without any particular standard to evaluate the validity of claims.[2] The question is whether the new regulation will specify a level of evidence that would prove a claim, whether it is tied to a federal or state standard.

New tools for ED to recover from institutions

ED came to the January session with a proposal to expand the administrative actions it can use to recover from institutions based on their conduct cited in student BDR claims. ED also posed the key question of what sort of evidence would be required for ED to obtain such recovery (which could be different than the level of proof required for a student to prevail in a claim).

However, many negotiators took a different tack by focusing on how students and their potential BDR claims could be "protected" even before any claims are made. Some suggested that institutions with a certain volume or severity of BDR claims, or other unspecified "risk factors," should be required to post a letter of credit, receive their federal student aid funds under heightened monitoring procedures that can delay the delivery of those funds, and require schools to make additional public disclosures. Some of the suggested risk factors included the institution's reliance on federal student aid funding as measured under the "90/10 Rule," gainful employment rates, withdrawal rate or rates, pending investigations by certain agencies, lawsuits filed against the school, or the institution's composite score under the financial responsibility metrics. ED obviously was listening to these voices, since its new position paper tracks many of these proposals to require institutions to post a letter of credit if they hit these and other triggers.

Some negotiators also suggested that owners or others who control a school should be required to post their personal funds or assets as collateral in case an institution was unable to absorb the cost of repaying loans that are forgiven under the new regulation, and this subject may come up for further discussion as well.

Process notes

While the BDR regulations[3] have been on the books since 1995, their importance as an enforcement tool with the potential for huge costs to institutions only came into focus after the closure of Corinthian Colleges in the summer of 2015. Based on that closure and the waves of negative publicity about the proprietary sector, and with strong urging from ED and legal assistance groups, more than 7,500 students have applied for relief totaling $164 million and those numbers are sure to climb.

As with any negotiated rulemaking, the panel must come to consensus on all issues in order for the Department to adopt the panel's recommendation in the new regulations. Otherwise, ED will draft regulations based on its own policy preferences after the negotiations conclude in March. While no observers expect consensus on this contentious regulation, the negotiations are still important to understand the pressures being brought to bear on ED and where ED may be headed.

ED's proposed regulations would be issued for comment under the normal public comment process, probably in the summer of 2016, with the goal to publish a final rule by November 1, 2016 to take effect on July 1, 2017.

The stage is set for ED to develop a broad new regulation that could offer loan relief to vast numbers of students and impose new costs on thousands of institutions. If you have any questions about Borrower Defense to Repayment regulations or would like more information about the negotiated rulemaking process, please see our brief summary of the matter, or contact us to further discuss the issue. Read the documents distributed to the group for this negotiation.

Notes

1. 34 CFR §§ 668.71-668.74.
2. 34 CFR § 685.206(c).

3. 20 USC § 1087e(h); 34 CFR § 685.206

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