

Borrower Defenses to Repayment – Summary of Proposed Rule

Prepared by NAICU - July 2018

The U.S. Department of Education published a Notice of Proposed Rulemaking (NPRM) regarding the Borrower Defenses to Repayment regulations on July 31, 2018. The public is offered a 30-day comment period window, closing on August 30, 2018. After the comment window closes the Department will parse the comments and publish a final rule. Below is NAICU's summary of the proposed rule:

- Proposes a full negotiated rulemaking panel to reform the financial responsibility standards to better align with current accounting standards and practices
 - The proposed rule updates the calculation of composite scores to reflect changes in FASB standards related to long-term leases, providing a six-year phase-in. Such time will provide the Department with the opportunity to update its composite score regulations through future negotiated rulemaking.
- Creates two separate processes for Borrower Defenses to Repayment claims: one standard for loans disbursed pre-July 1, 2019 and a different standard for loans disbursed post-July 1, 2019
 - The proposed regulations will only apply to loans disbursed after July 1, 2019; for loans disbursed prior to July 1, 2019 the Department will rely on existing rules and procedures.
- Establishes a new federal standard to determine whether a school's act or omission constitutes a basis for a borrower defense discharge on or after July 1, 2019
 - From 1995-2015 the Department relied on judgments based on state law to determine whether a borrower could be relieved of his or her loans. The Obama-era regulations created a federal standard, but the Trump Administration delayed the implementation of those regulations. After fierce discussion and debate at the negotiated rulemaking sessions, the Trump Administration has decided to create a federal standard, declaring that "A clear federal standard is required in order to adjudicate borrower defense claims in a fair and equitable manner." The federal standard would need to be followed for relief, and borrowers may no longer use decisions under state law as a justification for relief (see below).
- Eliminates group claims process
 - The Obama-era regulations allowed for borrowers to file group claims in order to expedite the claims process and bundle similar cases. The proposed rules intend to do away with a group claims process and will instead require individual borrowers to file their own defense to repayment application.
- Eliminates closed school discharge defense if the institution closes in an approved and orderly fashion
 - Borrowers attending an institution closing in an orderly manner and providing an accreditor-approved teach-out plan will **not** be eligible for defense to repayment. The proposed regulations seek to encourage distressed institutions to close in an orderly

manner, rather than the precipitous manner in which Corinthian and ITT Tech shuttered. Because private, nonprofit colleges almost always close with a proper teach-out plan in place, this proposed rule would reward those institutions for their fiscal stewardship by eliminating any potential financial liability rather than treating orderly closures identically to precipitous closures.

- Modifies definitions of misrepresentation and financial harm
 - The proposed rule would update the Obama-era definition of “substantial misrepresentation” to tighten the definition and eliminate a breach of contract as a triggering event. The Department also will rely solely on misrepresentation as the basis for discharge, rather than also allowing final judgments under state laws to serve as a basis for discharge. Although state judgments may be presented as evidence, the Department is committed to the notion that “an exclusively federal standard for borrower defense to repayment applications is appropriate.” The NPRM also requires that borrowers show “financial harm” rather than showing that they reasonably-relied upon the misrepresentation to his or her detriment as a baseline for seeking a defense to repayment.
- Provides the opportunity for a school to know that a defense to repayment claim has been lodged against it and to respond to claims made in that application
 - Under the Obama-era rules, schools were not offered a chance to provide evidence of non-malfeasance when a claim had been filed against them. Under the proposed rule, schools would have the chance to submit evidence to the Department in a timelier and more orderly fashion. However, once the Department has made a final determination about whether a student is relieved of their repayment, there is no appeals process for either the institution or the borrower.
- Establishes a time limit for the Education Department to initiate action to collect from the school the amount of any loans that are subject to an approved discharge
 - The Education Secretary will have five years to recoup funds from an institution once a borrower receives relief. Under the Obama-era rules the time limit was three years.
- Maintains the preponderance of the evidence standard – for now
 - The proposed rule maintains using a preponderance of the evidence standard to evaluate borrower defense claims brought against institutions. However, the Department is seeking comment on whether it should change the evidentiary standard to “clear and convincing” should it expand the universe of claims to include both “defensive” and “affirmative” claims as a means to prevent the filing of frivolous claims. Under the proposed rule, a borrower can only file a claim defensively, or when they are already in default and in danger of a recollection activity on behalf of the federal government. Under the Obama-era regulations, borrowers could also file claims affirmatively, or before they had actually defaulted on their loans.
- Maintains some of the mandatory triggers, but shifts most triggers to the discretion of the Department

- The Obama-era regulations included several mandatory triggers that were viewed as speculative in nature or more suited to accreditor action than action by the Department. Several of those mandatory triggers have been shifted to the discretion of the Department. The mandatory triggers that remain include a recalculation of the institution's financial responsibility ratio to determine whether the payment of those liabilities would cause the institution's composite score to fall below 1.0. Should the ratio fall below a 1.0, the Department could require additional financial surety, such as a letter of credit.
- Establishes procedures to determine a school's liability for the amount of any loan discharges resulting from a successful claim
 - Although institutions and students will be bound by the Department's decision on borrower relief, institutions will have the right to go through a "Subpart G" hearing process to determine institutional liability. The Department will not approach the student claims process from a presumption of full relief, and instead will judge each individual claim by its own merit, meaning that partial relief is a likely outcome.
- Restores the right of institutions to include pre-dispute arbitration and class action waivers as a condition of enrollment
 - This change affects the for-profit sector almost exclusively.
- Amends the eligibility criteria for the false certification loan discharge by specifying that the borrower would not qualify for a false certification discharge if they have attested otherwise
 - The proposed rule would allow institutions to enroll students who attest to having a high school degree, even if they cannot provide evidence of the degree. However, the proposed rule would terminate the ability of an attesting student to later claim a defense to repayment under the false certification defense.