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Comment on Proposed Rule: Student Assistance General Provisions [DN 2016-14052]
Docket ID: ED-2015-OPE-0103

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Please allow me to comment on the proposed regulation, "Student Assistance General Provisions, Federal Perkins Loan Program, Federal Family Education Loan Program, William D. Ford Federal Direct Loan Program, and Teacher Education Assistance for College and Higher Education Grant Program." I am a policy analyst at the Manhattan Institute for Policy Research, where my research centers on the economics of higher education. My commentary on higher education policy has been published in Forbes, Fortune, and RealClearPolicy. The opinions expressed below are my own and do not represent the institutional positions of my employer. Please do not hesitate to contact me (email and phone information listed above) if there are any questions regarding my comments.

My comments are organized into nine parts below and touch on various sections of the rule: the retroactive elimination of the three-year limitation for claims under the current system; the applicability of triggering events to public institutions; lawsuits filed by federal and state oversight entities; summary judgments in suits by private parties; the default rate trigger; the significant fluctuation in Title IV program volume trigger; the financial protection requirements; the 30-day financial protection window; and the proprietary institution repayment rate warnings.

**1. Retroactive Elimination of Three-Year Record Retention Period**

Under Sec. 685.206(c) of current regulations, the Secretary of Education may attempt to recover from colleges any losses the U.S. Department of Education (hereafter "the Department") incurs from an approved borrower defense claim. However, current regulations in Sec. 685.309(c) also state that the Department may not seek to recover such funds from colleges after the expiration of a "record retention period," defined as three years after the end of the award year in which the student last attended the institution.

The proposed regulations eliminate this three-year limitation entirely, meaning that the Secretary may attempt to recover funds from colleges at any point. This is a welcome move for taxpayers, who may incur fewer losses from the new defense to repayment procedure than they would otherwise. As long as the Department is open about this provision when colleges agree to accept Direct Loan funds, the institutions should have no cause for complaint, as they can simply refuse to participate in the Direct Loan program if they do not like its conditions.

However, the Department would be remiss to apply this new standard retroactively, as the regulations propose. The notice of proposed rulemaking states, "the Department … can apply the revised rule to any claim, without regard to when the claim arose" (39358).[1] In effect, the terms and conditions of student loans which were first disbursed before the Department even proposed the new regulation would be retroactively changed. Colleges that expected to be free of any liability resulting from a borrower defense after three years will suddenly face a potential liability they have not planned for, and one they did not agree to accept when they decided to participate in the Direct Loan program. The Department cannot change the rules after the game has begun.

The Department rightly applies most other provisions in the proposed rule only to Direct Loans first disbursed on or after July 1, 2017. This allows colleges to reevaluate whether they wish to participate in the Direct Loan program given the new conditions attached to loan disbursements. The elimination of the three-year limitation period on loss recovery from institutions is a welcome change that will surely benefit taxpayers. However, there is no justification for making this provision of the proposed rule uniquely retroactive. In fact, the Department may open itself up to lawsuits by retroactively changing the terms of the contract.

I suggest that the Department change Sec. 685.206 to make the abolition of the three-year limitation period on loss recovery from institutions only applicable to borrower defense claims on loans first disbursed on or after July 1, 2017.

**2. Applicability of Triggering Events to Public Institutions**

The Department proposes to restructure CFR Sec. 668.171 to add several "triggering events" which, if they occur, will cause an institution to be labelled not financially responsible. This would cause the loss of the institution's access to Title IV funds unless the institution puts up substantial financial protection, such as a letter of credit, within 30 days.

I have additional comments about the nature of the triggering events themselves (discussed below), but allow me to use this part to comment on the applicability of the triggers to various sectors of higher education.

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[1] All page numbers refer to the published notice of proposed rulemaking (NPRM) in the Federal Register. "Student Assistance General Provisions, Federal Perkins Loan Program, Federal Family Education Loan Program, William D. Ford Federal Direct Loan Program, and Teacher Education Assistance for College and Higher Education Grant Program; Proposed Rule." *Federal Register Vol. 81, No. 116,* June 16, 2016. Available at: https://www.gpo.gov/fdsys/pkg/FR-2016-06-16/pdf/2016-14052.pdf

Current regulations provide that the standards of financial responsibility, which the Department proposes to strengthen, only apply to private nonprofit and private for-profit schools. Such a limitation may be justifiable under current regulations, but the Department proposes to substantially expand the circumstances under which a college may be considered not financially responsible.

Many public colleges, which are currently exempt from the financial responsibility triggers, may violate them regardless. For example, a college is considered not financially responsible if it is sanctioned by an accreditor. The same week the proposed regulations were published in the Federal Register, the Southern Association of Colleges and Schools, an accreditor, put on probation Angelina College, a public community college in Texas.[2] According to the Government Accountability Office, 28 public institutions received a probation or show-cause order from October 2009 to March 2014. During the same period, 33 nonprofit institutions received those sanctions.[3]

If the Department believes that an accreditor sanction is just cause to label an institution not financially responsible, then there is no reason to apply that standard to some colleges and not to others. Public colleges and nonprofit colleges receive almost the same number of accreditor sanctions, yet the former are exempt from the new regulations and the latter are not.

The Department therefore cannot justify applying different rules to different institutions. If it must write these new "triggers" into the Code of Federal Regulations, it should apply them equally, or not at all. If the Department decides to keep the proposed new provisions in Sec. 668.171, I suggest that the Department amend Sec. 668.171 to apply the triggering actions to public colleges. This could be accomplished by striking proposed Sec. 668.171(e) from the rule.

**3. Lawsuits by Federal or State Oversight Entities**

In Sec. 668.171(c)(1)(i)(B) and Sec. 668.171(c)(1)(ii) of the new regulations, the Department proposes to include as a "triggering event" any major lawsuit filed by a state or federal oversight entity such as a state attorney general or federal regulatory body. The plaintiff in these cases would not be required to prove anything, or even show that the suit has merit, in order to have an institution automatically labeled not financially responsible. Within thirty days after an oversight entity files suit, the defendant institution would need to put up a letter of credit equal to 10 percent or more

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[2] Ellen Wexler, "Southern Accreditor Puts Five Colleges on Probation." *Inside Higher Education,* June 20, 2016. Available at: https://www.insidehighered.com/news/2016/06/20/southern-accreditor-puts-five-colleges-probation

[3] "Education Should Strengthen Oversight of Schools and Accreditors." *United States Government Accountability Office,* December 2014. Available at: http://www.gao.gov/assets/670/667690.pdf

of its latest annual federal student loan volume, or else lose access to Title IV aid. This would continue for as long as the suit remains unresolved.

The Department's right to place whatever conditions it likes upon receipt of federal Title IV funds is not at issue here. However, this provision will be ineffective at achieving the Department's stated goal of promoting accountability and compliance among Title IV-participating institutions, and would present its own set of problems.

State attorneys general, under the regulation, will have the ability to force a college to accept a significant financial burden without any independent verification of whether the allegations against the institution have any merit. Since lawsuits can often drag on for years without resolution, it is not inconceivable that such a lawsuit could mean a death sentence for the targeted institution, even if the facts are on its side.

The Department has not provided a convincing justification as to why this "trigger" will promote compliance among schools. The whole point of the new regulation is to standardize at the federal level rules governing when fraudulent behavior should revoke colleges' access to Title IV. Yet under this section, institutions would need to focus on staying on the good side of many different oversight entities across all fifty states and the federal government.

It is entirely unclear what standards, if any, the various entities would use when deciding whether to file lawsuits. And the institutions would have no opportunity to defend themselves against the allegations made before facing financial consequences. This creates the likelihood of arbitrary and politically motivated filing of lawsuits. What if the interests of state attorneys general and other oversight entities do not align with the public interest of filtering out poor-quality and fraudulent colleges? And what would discourage oversight entities from filing frivolous lawsuits, when they could easily force colleges into closure without having to prove that any of the allegations made therein have merit? The Department has not addressed these dangers in its proposed rule.

Moreover, the stated purpose of the "triggering events" section of the regulation is to "identify, and take action regarding, material actions and events that are likely to have an adverse impact on the financial condition or operations of an institution." This is in order to protect taxpayers against potential losses before students file a deluge of borrower defense to repayment claims seeking loan forgiveness. But this section of the rule could end up a self-fulfilling prophecy: if colleges cannot obtain a significant letter of credit within thirty days, they will lose access to Title IV funding and may be forced to close, shifting more of the financial burden of successful repayment claims onto taxpayers.

The Department should require a lawsuit to be resolved in the plaintiff's favor before an institution activates one of the new "triggers" and faces financial consequences. At the very least, there should be some sort of independent verification of the college's alleged wrongdoing or irresponsibility. In Sec. 668.171(c)(1)(i)(A), the Department already makes a triggering event the resolution of a lawsuit in which the defendant college has to pay a significant amount. That should be enough; there is no reason to make the filing of a lawsuit a triggering event as well. Therefore, I propose that the Department strike Sec. 668.171(c)(1)(i)(B) and Sec. 668.171(c)(1)(ii) from the proposed regulation.

**4. Summary Judgment in Suits by Private Parties**

In addition to major lawsuits filed by public oversight entities, in Sec. 668.171(c)(1)(iii) the Department also makes a "trigger" a lawsuit filed by a private party under the False Claims Act. However, the Department requires these lawsuits to survive a summary judgment before the defendant institution is subject to financial consequences. This is an improvement over the rule set out in Sec. 668.171(c)(1)(i)(B) and Sec. 668.171(c)(1)(ii) and discussed in Part 3 above, which does not require lawsuits to survive any sort of test of their merit.

However, the summary judgment rule still has flaws. It essentially presents the defendant institution with a choice. The institution can file a motion for a summary judgment, taking the risk that the motion will be denied and the college automatically labeled not financially responsible. Or, the institution can refrain from filing a motion for summary judgment and endure the time and expense of fighting the lawsuit in court. In all likelihood, even institutions that would likely win a summary judgment motion will opt for the latter course of action, due to the newly introduced financial risk involved with filing such a motion.

The financial consequences of losing a motion for summary judgment that the proposed rule introduces represent unjustified meddling in the natural course of civil court cases. The rule will discourage the use of summary judgment motions, which are an important tool to dismiss frivolous lawsuits before they consume too much time and money.

In addition, surviving a motion for summary judgment is a low bar to clear. To survive, the court need not determine that the lawsuit has merit, but only that there are facts and questions still to be resolved. A defendant institution with a high chance of winning the lawsuit against it may still lose a motion for summary judgment, yet will be punished under the regulations anyways.

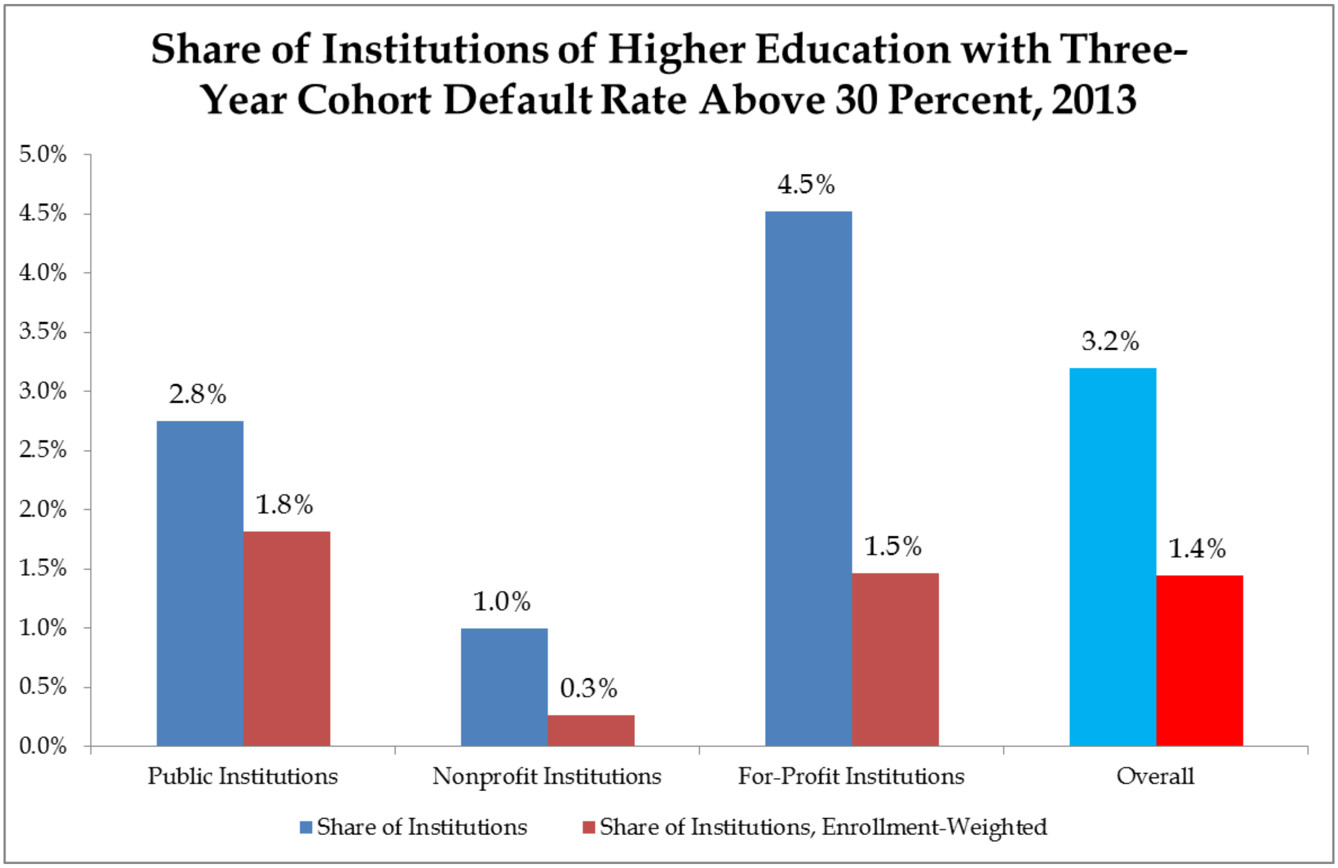
For these reasons, I propose striking Sec. 668.171(c)(1)(iii) of the proposed regulation. If the Department still desires to incorporate private lawsuits as triggers, it should amend Sec. 668.171(c)(1)(iii)(A) to read that the settlement or resolution of lawsuits, for a material amount, by private entities under the False Claims Act, qualifies as a "triggering event" under Sec. 668.171(c).

**5. Default Rate Trigger**

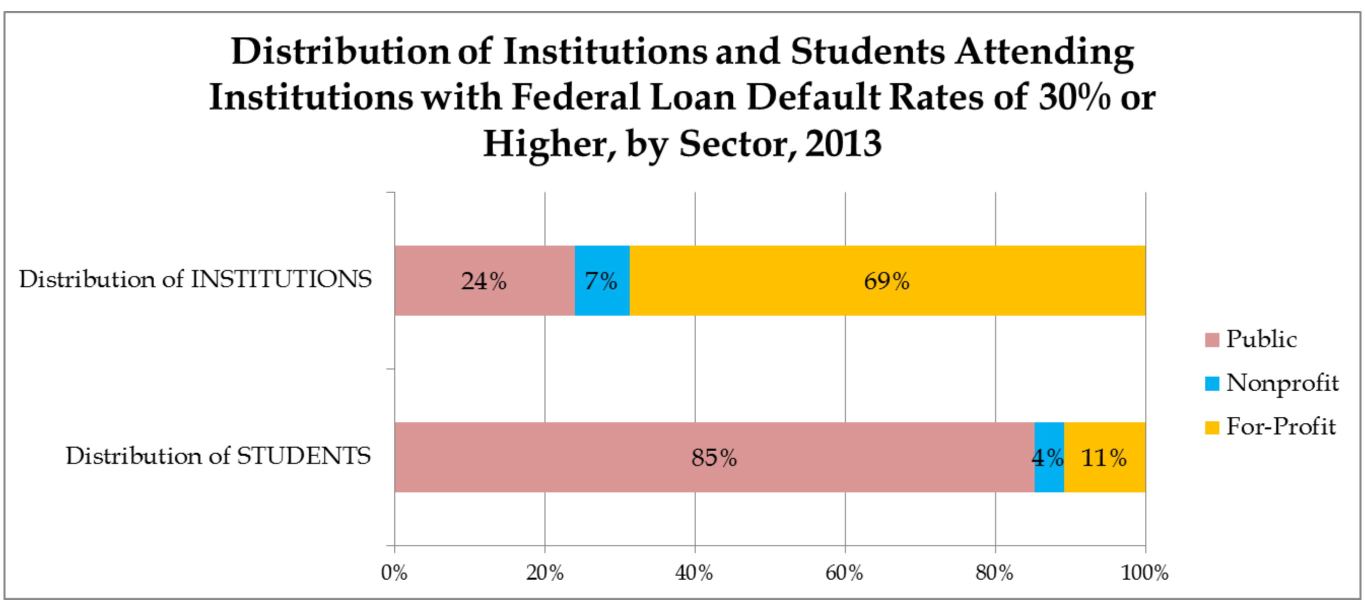
In Sec. 668.171(c)(9), the Department proposes that an institution will activate a "trigger" if its two most recent cohort default rates are 30 percent or higher. I recommend, as the Department has considered, that this trigger apply to any institution whose *most recent* cohort default rate is 30 percent or higher. Keeping default rates below 30 percent is a very low standard for an institution to meet—only 3.2 percent of institutions have a default rate of 30 percent or higher.[4]

Additionally, this is another reason that the Department should apply the "triggering event" rules in Sec. 668.171(c) to public institutions as well as private. About 2.8 percent of public institutions have default rates of 30 percent or higher, only slightly lower than the overall number. Weighting for full-time equivalent enrollment, 1.8 percent of public institutions have default rates of 30 percent or higher, a higher rate than the for-profit sector (see figure).

[4] According to my analysis of IPEDS data. Figures refer to three-year cohort default rates for 2013. Source: "Performance Data by Accreditor." *United States Department of Education,* Accessed June 30, 2016. Available at: http://www2.ed.gov/admins/finaid/accred/summaryoutcomesdata.xls




Among all students attending institutions of higher education where the default rate is 30 percent or higher, 85 percent attend public institutions. Just 11 percent attend for-profit institutions (see figure). If the Department's goal is to protect as many students as possible, it must not create an exemption for public institutions under Sec. 668.171(e) of the regulation.



**6. Significant Fluctuations in Title IV Program Volume**

Sec. 668.161(c)(10)(i) of the proposed regulation would add as a triggering event any "significant fluctuation" in Title IV program volume. However, "significant fluctuation" is left undefined. The Department implies on page 39393 of its NPRM that it believes a reasonable standard would be a 25 percent or greater change in the amount of Title IV aid a school receives from year to year, after accounting for changes in Title IV programs. However, the Department should clarify the precise level in the text of the regulation and not leave institutions to guess. How can an institution comply with a rule when the Department does not reveal what the rule is?

Moreover, evidence suggests that the Department may be evaluating colleges by the wrong metric. The for-profit college sector has seen six-fold enrollment growth over the past 25 years.[5] "Significant fluctuations" in Title IV program volume may be a reflection of that expansion. Put another way, a significant fluctuation in Title IV program volume, without looking at important contextual clues, is insufficient to determine whether there is in fact questionable conduct at the institution. Additionally, including significant fluctuation as a trigger may serve as a deterrent to colleges' growth, since a large increase in enrollment would trigger the financial protection requirement even if that increase is perfectly legitimate.

Deterrents to growth favor large, established institutions which have little room to grow and penalize smaller institutions that could challenge the dominance of entrenched players. According to my analysis of IPEDS data, a ten percentage point increase in a for-profit college's enrollment growth rate is associated with a full-time equivalent enrollment level 4.2 log percentage points lower (see figure).[6] In other words, the faster-growing colleges, which will be penalized by this rule, are small ones. The Department should try to promote competition in the higher-education sector, not stifle it.

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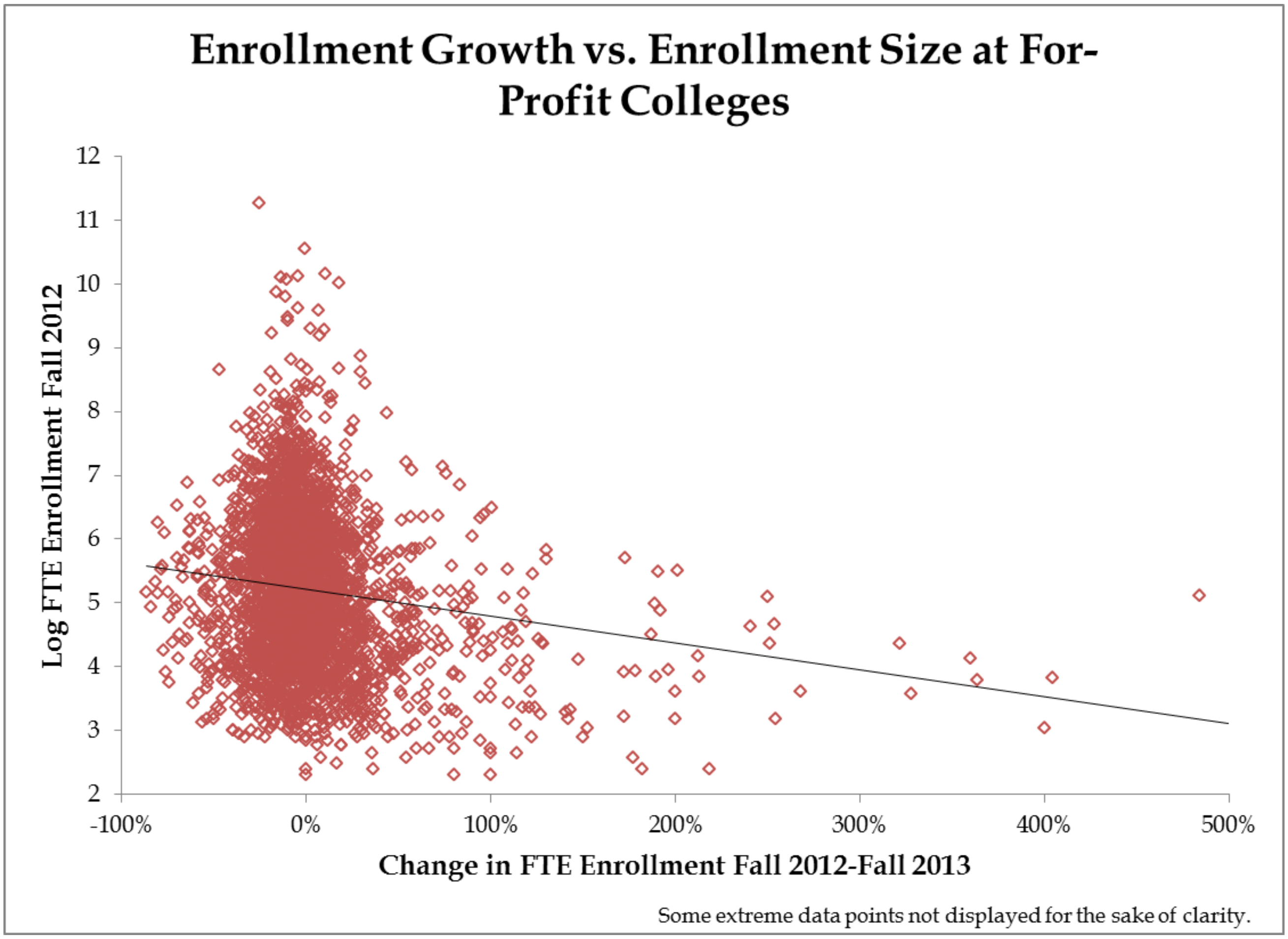
[5] "Digest of Education Statistics, Table 303.10." *National Center for Education Statistics,* Accessed July 11, 2016. Available at http://nces.ed.gov/programs/digest/d15/tables/dt15_303.10.asp?current=yes

[6] Based on a sample of 3,173 for-profit colleges, comparing full-time equivalent (FTE) enrollment in Fall 2012 to the FTE enrollment change from Fall 2012 to Fall 2013. Only institutions with FTE enrollment greater than 10 were included.




An analysis for the Brookings Institution by Seton Hall University economist Robert Kelchen corroborates this point. Kelchen shows that small colleges would be disproportionately affected by this provision of the proposed rule, while just a handful of large colleges would.[7]

While the Department certainly has a compelling interest in ensuring colleges do not raise tuition unnecessarily to take advantage of Title IV aid generosity, it should try to address this problem in a way that does not discourage institutions from expanding their enrollment.

I propose the Department amend Sec. 668.171(c)(10)(i) to make this section's "trigger" a significant fluctuation in Title IV program volume *per aid recipient*, not program volume overall. This would guard against increases in tuition designed to take advantage of Title IV program generosity while not also penalizing colleges with rapid enrollment

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[7] Robert Kelchen, "Proposed Student Finance Regulations May Hamper Small Institutions." *Brookings Institution*, July 18, 2016. Available at: http://www.brookings.edu/blogs/brown-center-chalkboard/posts/2016/07/18-student-finance-regulations-hamper-small-institutions-kelchen

growth. I suggest a threshold of an 8.7 percent annual change to define what constitutes a "significant fluctuation."[8]

**7. Clarification of Financial Protection Requirements**

Sec. 668.171(f)(2)(i) and Sec. 668.171(f)(4) of the proposed regulation provide that a triggering event would require the affected institution to put up financial protection equivalent to 10 percent or more of the Title IV funds received in the previous year, or 10 percent or more of the previous year's Direct Loan funds for a federal or state action under Sec. 668.171(c)(1)(i)(A) or (B).

On page 39368 of the NPRM, the Department states: "To be clear, each of these triggering events would require a form of financial protection, such as a letter of credit, of at least 10 percent, so an institution with three triggering events would have to submit financial protection for at least 30 percent of its prior year title IV, HEA program funds."

The Department should clarify which events qualify as separate "triggers" under the rule. For example, if three state attorneys general join a suit against an institution, does that count as three triggering events or just one? Under such a situation, must the letter of credit the school supplies equal 30 percent of its Direct Loan funds, or just 10 percent? What if the attorneys general or other oversight entities file separate lawsuits? Would that count as three events or one?

The Department has noted in its NPRM the rise of distance education as a motivation for developing the new rule. It is entirely conceivable that a national distance education provider could face lawsuits from several attorneys general at once, resulting in a potentially enormous required letter of credit. This puts distance education providers at a disadvantage to traditional physical institutions for which fewer attorneys general would have standing to sue.

I suggest the Department clarify Sec. 668.171(f)(4) to specify whether multiple actions under Sec. 668.171(c) (e.g., lawsuits filed by multiple state attorneys general) qualify as multiple triggering events or a single triggering event. I propose that the Department treat these actions as a single triggering event as to not unfairly disadvantage distance education providers over traditional institutions. If the Department must treat them as multiple triggering events, I propose that the Department cap required financial

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[8] This is equivalent to three times the annual change, from the 2012-13 academic year to 2013-14, of aggregate revenues from tuition and fees per full-time equivalent student across the public, nonprofit, and for-profit college sectors. Source: "Digest of Education Statistics, Tables 333.10, 333.40, and 333.55." *National Center for Education Statistics,* Accessed July 11, 2016. See http://nces.ed.gov/programs/digest/current_tables.asp

protection at 100 percent of Title IV funds, to prevent an excessive financial burden on institutions.

**8. Implications of Triggering Events for Institutions**

The Department should consider revising up the 30-day period in Sec. 668.171(h) which it gives institutions to provide financial protection in the event that the school activates one of the financial responsibility "triggers" outlined in Sec. 668.171(c). As the Department states on page 39368 of its NPRM, many schools will comply with the financial protection mandate by putting up a letter of credit collateralized by physical assets. However, this will be difficult for many schools, particularly the distance education providers which the Department identifies on page 39335 of the NPRM as targets of the new rule.

If an otherwise financially healthy school loses access to Title IV funding because it could not obtain a letter of credit within 30 days, it may fail, increasing the risk to taxpayers. Therefore, I propose that the Department increase the grace period specified in Sec. 668.171(h) to 90 days or more, or at the very least give institutions the option to appeal for more time.

**9. Applicability of Repayment Rate Warnings to Public and Nonprofit Institutions**

In proposed Sec. 668.41(h), the Department proposes to require that a Title IV-participating for-profit institution warn prospective students if its federal loan repayment rate is less than or equal to zero percent. This repayment rate is not the standard repayment rate reported in College Scorecard data, but relies on a different calculation method. Specifically, the repayment rate is equal to the average percentage difference between a student's outstanding loan balance upon entering repayment and his current outstanding balance. If a majority of former students cannot make interest payments on their loans, the repayment rate will be negative.

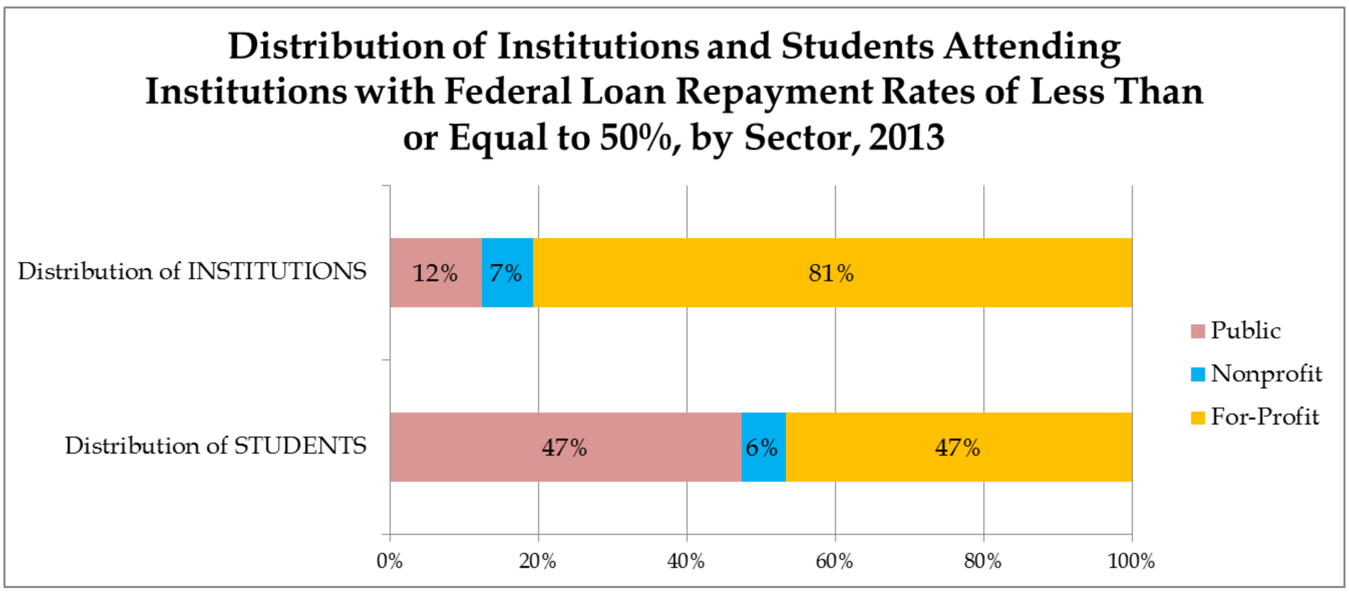
There are two problems with this proposed section. First, the Department proposes to record a student's repayment rate as zero if he makes progress on his loan balance but then defaults, but uses the standard repayment rate calculation if his outstanding balance goes up prior to a default. This is an inconsistent standard that will skew repayment rate statistics down. The Department should pick a method—enter defaults as zeros, or give them no unique treatment—and stick to it.

Additionally, the Department intends only to apply Sec. 668.41(h) of the rule to for-profit institutions, arguing in its NPRM that "analysis of repayment performance under the proposed methodology shows that zero and negative repayment outcomes are endemic to the proprietary sector, but are relatively rare in the public and non-profit sectors" (39372).

While for-profit schools do have a higher incidence of low repayment rates than other sectors, a significant number of students attend public and nonprofit institutions that have zero or negative repayment rates, and thus would be required to warn prospective students should the Department decide to apply the rule in Sec. 668.41(h) to them.

On page 39373 of its NPRM, the Department states that schools with a standard repayment rate of 50 percent or less would probably trigger the warning requirement under the proposed regulation. Therefore, as it is the only relevant metric publicly available, I will use it as a proxy for the new standard in the following analysis.

Of institutions with repayment rates less than or equal to 50 percent, 81 percent are in the for-profit sector. However, weighting for enrollment shows that the for-profit sector accounts for just 47 percent of full-time equivalent students enrolled in institutions with repayment rates that fall in this range. Another 47 percent of these students attend institutions in the public sector (see figure). However, unlike their counterparts in the for-profit sector, these students will not receive a warning about their institution's low repayment rate.[9]




If the Department believes the repayment rate warnings under Sec. 668.41(h) of the proposed rule are necessary to protect students, it must apply the rule to all sectors of higher education, especially the public sector. Otherwise, the Department is leaving over 1.3 million full-time equivalent students exposed, by its own admission, to institutions at which enrollees are not likely to repay their loans.

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[9] According to my analysis of IPEDS data. Data are from 2013. Source: "Performance Data by Accreditor." *United States Department of Education,* Accessed June 30, 2016. Available at: http://www2.ed.gov/admins/finaid/accred/summaryoutcomesdata.xls

**Conclusion**

The Department is well within its rights to attach new conditions to the disbursement of Title IV aid. However, the Department ought to reconsider some of the provisions in its proposed rule, particularly the retroactive elimination of the three-year limitation on defense to repayment claims under current regulations, which amounts to rewriting the rules after an agreement has been struck. In addition, the Department should consider whether many of the “triggering events” in its proposed rule will actually contribute toward the Department’s stated goal of promoting compliance and accountability among institutions. The Department also ought to rethink its exclusion of public institutions from this section of the rule. Finally, the Department’s belief that low repayment rates are only a problem in the for-profit sector is misplaced, and if it intends to keep the “repayment rate warning” provision of the proposed rule, it should apply the provision to all sectors of the higher education sphere, not just the for-profit sector.

I thank the Department for considering my comments on this proposed regulation, and I look forward to reading the final rule.