



# Proceed with Caution! Important Changes to the U.S. Department of Education's Change in Ownership and Financial Responsibility Regulations

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# Topics We're Covering Today

- ▶ Identifying changes in ownership requiring ED approval.
- ▶ Revised ED standards for “other entities” (LLCs, LLPs, LPs and similar types of legal entities or corporations that are neither closely held nor publicly traded).
- ▶ Revisions to scope of “excluded transactions.”
- ▶ Revised “nonprofit institution” definition for Title IV.
- ▶ Two-step process for acquisitions involving Title IV institution becoming an additional location of another Title IV institution.
- ▶ Required notifications and reporting.

# Topics We're Covering Today (cont.)

- ▶ “Materially complete” ED application requirements.
- ▶ Maintaining the Temporary Provisional Program Participation Agreement following a change in ownership and control.
- ▶ Post-transaction conditions from ED.
- ▶ ED pre-acquisition review.
- ▶ Title IV Program Participation Agreement signatories.
- ▶ Proposed Financial Responsibility changes for changes in ownership.
- ▶ Proposed new mandatory and discretionary Financial Responsibility triggers requiring Letter of Credit or other protection.
- ▶ Additional proposed circumstances that would deem an institution not financially responsible.

# Key Resources

- ▶ Final Change in Ownership regulations, published 10/28/2022 and effective 7/1/2023.
- ▶ Proposed Financial Responsibility and Title IV Certification regulations, published 5/19/2023. (Final regulations expected by 11/1/2023 to be effective 7/1/2024.)
- ▶ Electronic Announcement GENERAL-22-16 (3/23/2022): “Updated Program Participation Agreement Signature Requirements for Entities Exercising Substantial Control Over Non-Public Institutions of Higher Education.”
- ▶ Electronic Announcement GENERAL-22-70 (9/15/2022): “Updated Guidance and Procedures for Changes in Ownership.”
- ▶ Electronic Announcement GENERAL-23-11 (3/1/2023): “Establishing Personal Liability Requirements for Financial Losses Related to the Title IV Programs.”
- ▶ Electronic Announcement GENERAL-23-46 (6/14/2023): “Sunset of COVID-19 Waivers and Flexibilities.”

# ED Rationale for Revising Change in Ownership Regulations

- ▶ Change in ownership and/or control transactions are growing in complexity.
- ▶ Review of transactions has been taking up to a year, with limbo putting pressure on schools and ED.
- ▶ Desires more streamlined process that ensures compliance with regulations.
- ▶ Changes are intended to provide ED with adequate notice to evaluate transactions before they occur.
- ▶ Changes address concerns about transactions that convert for-profit institution to nonprofit status.

# Identifying Changes in Ownership Requiring ED Approval

- ▶ ED regulations have long-established standards for identifying changes in ownership and control that require its approval for continued Title IV participation, based on the type of institution or parent entity:
  - ▶ Closely-held corporation (including “close corporation”)
  - ▶ Publicly-traded corporation registered with the SEC
  - ▶ General partnership or sole proprietorship
  - ▶ Nonprofit institutions
  - ▶ Public institutions
  - ▶ “Other entities” (including other types of corporations, LLCs, LLPs, LPs and similar entities)

# Identifying Changes in Ownership Requiring ED Approval (cont.)

- ▶ ED regulatory changes effective 7/1/2023 relate most substantively to “**other entities**” (LLCs, LLPs, LPs and similar types of legal entities or corporations that are neither closely held nor publicly traded).
- ▶ Current standard for such “other entities” is effectively a 25% and control test.
- ▶ Final rule generally changes “other entities” standards to:
  - ▶ Acquiring 50% or more of the total outstanding voting interests in the entity, or otherwise acquiring 50% or greater control.
  - ▶ Ceasing to hold at least 50% voting interest, or otherwise ceasing to hold 50% control.



# Change in Ownership Standards for “Other Entities”

- ▶ ED regulatory changes related to “other entities” (continued)
  - ▶ Acquiring or ceasing to own at least 50% of the voting interests in a general partnership, or otherwise acquiring or ceasing to hold 50% control.
  - ▶ Any change of a general partner of a limited partnership (or similar entity) if that general partner also holds an equity interest.
  - ▶ Any change in a managing member of a limited liability company (or similar entity) if that managing member also holds an equity interest.
  - ▶ An entity that has a member or members ceases to have any members.
  - ▶ An entity that has no members becomes an entity with a member or members.

# Change in Ownership Standards for “Other Entities” (cont.)

- ▶ ED regulatory changes related to “other entities” (continued)
  - ▶ Notwithstanding voting interests, becoming the sole member or shareholder of LLC or other entity that has a 100% or equivalent direct or indirect interest in the institution.
  - ▶ Replacing the sole member or shareholder of LLC or other entity that has a 100% or equivalent direct or indirect interest in the institution.
  - ▶ Transfer of 50% or more of the voting interests to an irrevocable trust, or upon death of an owner who previously completed such a transfer, except where transfer meets the definition of an “excluded transaction.”
  - ▶ Addition or removal of any entity providing audited financial statements to ED for the purposes of Title IV financial responsibility requirements.

# Change in Ownership Standards for “Other Entities” (cont.)

- ▶ Measuring the 50% threshold:
  - ▶ Combined ownership interest of at least 50% as a result of proxy agreements, voting agreements, or other agreements (whether or not in writing), or by operation of State law.
  - ▶ Combined ownership interest of at least 50% as a result of common ownership, management, or control of that entity, either directly or indirectly.
  - ▶ Combination of “family members” (as defined by 34 CFR 600.21 (f)) holds combined ownership interest of at least 50%.

# Change in Ownership Standards for “Other Entities” (cont.)

- ▶ Notwithstanding the 50% threshold:
  - ▶ ED may determine that a person, who alone or in combination with other persons holds less than a 50% ownership interest in an entity, has actual control over that entity.
  - ▶ Any person who alone or in combination with other persons has the right to appoint a majority of any class of board members of an entity or an institution is deemed to have control.

# Excluded Transactions

- ▶ Revised ED regulations retain exclusion for ownership transfers among “family members” as defined in 34 CFR 600.21 (f), and for transfers to certain management persons who have maintained an ownership interest for at least two preceding years.
- ▶ **New:** For transfers to irrevocable trusts to be excluded, the trustees must be current owner(s) and/or a family member(s). Upon the appointment of any non-family member as trustee for the trust (or a successor trust), the transaction is no longer excluded.

# Nonprofit Institution Definition (for Title IV purposes)

- ▶ For-profit institutions undergoing a change in status to nonprofit will remain in for-profit status (for all ED purposes) until ED approves nonprofit status.
- ▶ Nonprofit institution **generally is not** an institution that:
  - ▶ Owes debt to a former owner of the institution (or a person or entity affiliated with the former owner);
  - ▶ Either directly or through any entity in its ownership/control chain, maintains a revenue sharing agreement with former owners, current or former employees, board members, or entities or persons affiliated therewith (unless ED determines to be reasonable);
  - ▶ Is a party (either directly or indirectly) to any other agreements with former owners, current or former employees, board members, or entities or persons affiliated therewith (unless ED determines to be fair market value); or
  - ▶ Engages in an excess benefit transaction with any natural person or entity.

# “Materially Complete” Application

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- ▶ Required submission to ED of application and supporting documents within **10 business days** following transaction, in order to receive Temporary Provisional Program Participation Agreement (“TPPPA”).
- ▶ **State and accrediting approvals** accompanying the application must evidence, or be supplemented to evidence, such approvals remaining **in effect as of the day before the change** in ownership.
- ▶ Audited financial statements of the **two most recently completed fiscal years** for both the institution and the proposed new owner. (This is no longer satisfied by the two most recent fiscal years for which audits are available if a more recent fiscal year end has occurred.)

# Maintaining the TPPPA

- ▶ TPPPA is facially effective from date of the change until the last day of the month following the month of the change.
- ▶ However, the TPPPA is extended on a month-to-month basis if the institution, by **the last day of the month following the month in which the change occurred**, submits: (1) audited same-day balance sheet, (2) state and accrediting approvals of the change in ownership, and (3) any other information required by ED.
- ▶ If the above requirements are met, the TPPPA remains in effect until ED makes substantive determination on the change, including final approval via a new Provisional PPA (“PPPA”).



# Maintaining the TPPPA (cont.)

- ▶ Audited same-day balance sheet (SDBS) is typically required by ED at the **“highest unfractured ownership level”** (one of the parent entities) rather than the institution level.
- ▶ Extended deadlines under Covid-19 national emergency for institutions to provide ED with both SDBS and state and accrediting approvals are now subject to sunset:
  - ▶ National emergency ended April 10, 2023.
  - ▶ State and accrediting agency approvals and the audited SDBS or statement of financial position must be submitted by the later of October 10, 2023, or the last day of the month of the month following the change in ownership.
  - ▶ During sunset period, schools must still provide unaudited SDBS and auditor engagement letter by the non-extended regulatory deadline (last day of the month following the month in which the change occurred).

# Maintaining the TPPPA (cont.)

- ▶ ED considers two ratios when reviewing SDBS
  - ▶ Acid Test Ratio – current portions of cash and student receivables compared to current liabilities
    - ▶ Nonprofits must still report even if Statement of Financial Position does not report current and long-term
    - ▶ New lease accounting standard makes this more difficult as the right-of-use assets created are not included (and are all long-term) but lease liabilities include a current portion
- ▶ Tangible Net Worth - tangible assets (total assets less intangible assets) less liabilities must be at least \$1

# Post-Transaction Conditions

- ▶ Final change in ownership regulations codify ED past practices with respect to financial protections (e.g., Letters of Credit) that may be imposed following changes in ownership and control.
  - ▶ At least 25% of the institution's prior year Title IV volume if the new owner does not have two fiscal years of acceptable audited financial statements.
  - ▶ At least 10% of the institution's prior year Title IV volume if the new owner has only one fiscal year of acceptable audited financial statements.
  - ▶ **As deemed necessary in ED's discretion**, financial protection equal to an additional 10% of the institution's prior year Title IV volume, or such larger amount as determined by ED.

# Post-Transaction Conditions (cont.)

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- ▶ **Proposed Financial Responsibility regulations** would codify ED's assessment of several matters when determining whether to require financial protection following a change in ownership, including but not limited to past composite score compliance, past operating losses, acid test and tangible net worth requirements, and any acquisition debt.
- ▶ If any entity in the new ownership structure holds a 50% or greater direct or indirect voting or equity interest other institutions, the required financial protection may be based on a percentage of the prior year Title IV volume for all institutions under common ownership.

# Post-Transaction Conditions (cont.)

- ▶ **Proposed Title IV Certification regulations** would codify many conditions that may be imposed by ED under provisional certification, including following a change in ownership and control:
  - ▶ Restrictions on new programs, locations and/or enrollment growth.
  - ▶ Restrictions on future acquisitions and/or provision of teach-outs.
  - ▶ Ongoing reporting concerning finances, enrollments and student complaints.
  - ▶ Limitations on written agreements with other institutions to provide instruction.
  - ▶ Submission of marketing and other recruiting materials for ED review (if there have been past allegations or findings of wrongdoing).

# New Notifications Before a Change in Ownership Requiring ED Approval

- ▶ Under final CIO regulations (effective July 1, 2023), **no later than 90 days prior to a change in ownership**, an institution must:
  - ▶ Notify ED through a prescribed form, accompanied by (1) currently effective State authorization and accreditation documents and (2) audited financial statements for the two most recently completed fiscal years of both the institution and the proposed new owner. (This notification is distinct from any Pre-Acquisition Review filing.)
  - ▶ Notify enrolled and prospective students of the proposed change in ownership. (“Institutions must inform students individually via email or some other method of the proposed change in ownership. Electronic notifications provided directly to individual students would be acceptable, but a simple message on a web page would not be sufficient.”)

# Reporting Other Ownership Changes

- ▶ Final change in ownership regulations codify requirement to **report and update ED within 10 days** (presumably still through the E-App) of parties who have “control” even when there is not a change of control requiring ED approval:
  - ▶ Acquiring at least a 25% ownership (whether individually or in combination with other family members, affiliated persons or affiliated entities, or under a voting trust, power of attorney, proxy, or similar agreement).
  - ▶ Becoming the general partner, managing member, chief executive officer, trustee or co-trustee of a trust, chief financial officer, director, or other officer of the institution or of an entity that has at least a 25% interest.

# Reporting Other Ownership Changes (cont.)

- ▶ Final CIO regulations require **new reporting to ED when any person or entity acquires at least a 5% ownership interest** (direct or indirect), but which is not a change of control as described in 34 CFR 600.31.
- ▶ Must generally be reported each quarter based on the institution's fiscal year; however:
  - ▶ If an institution plans to undergo a change in ownership, all unreported ownership changes of 5% or more in the existing ownership must be reported prior to submission of the required 90-day notice.
  - ▶ Between the required 90-day notice and the change in ownership, any additional changes of 5% or more in the existing ownership must be reported within 10 days.



# ED Pre-Acquisition Review

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- ▶ Electronic Announcement GENERAL-22-70 (9/15/2022) discontinued “Comprehensive” Pre-Acquisition Review option
- ▶ “Abbreviated” Pre-Acquisition Review remains available and informs transaction parties:
  - ▶ Whether the institution will be required to post Letter(s) of Credit based on pre-transaction factors.
  - ▶ If multiple levels of ownership are identified in a prospective transaction, which level of ownership must submit the audited SDBS and future annual audited financial statements.
  - ▶ Enumerates the information and documents required to be submitted for both the “materially complete” application and subsequent deadlines to maintain Title IV eligibility.

# Acquisitions Involving a Title IV Institution Becoming a Location of Another Institution

- ▶ Electronic Announcement GENERAL-22-70 (9/15/2022).
- ▶ Transition from a freestanding Title IV institution to additional location of another Title IV institution must occur in two steps.
  - ▶ **Step 1:** A change in ownership must occur for the “non-surviving” institution that will become the additional location of the “surviving” institution.
  - ▶ **Step 2:** After ED has approved the change in ownership for the non-surviving institution, the surviving institution must submit an application to add the non-surviving institution as an additional location.
- ▶ Also, ED will not permit an institution to establish an “additional location” that is comprised solely of distance education coursework, even if an institution’s accrediting agency would permit such a location or branch campus under the agency’s standards.

# Title IV Program Participation Agreement (PPA) Signatories

- ▶ Changes in ownership resulting in changes of control result in new Title IV certification with a new Program Participation Agreement.
- ▶ ED has issued **two Electronic Announcements on PPA cosigning**, one regarding entities and the other regarding individuals, which are currently in effect.
- ▶ **Proposed Title IV Certification** regulations would revise and codify the PPA co-signing requirements for entities. As proposed, they would not affect the current EA policy for individual signatories (which would remain subject to the current EA policy).

# Title IV PPA Signatories: Entities

- ▶ Electronic Announcement GENERAL-22-16 (March 23, 2022)
- ▶ Effective July 1, 2022, PPA signature may be required from **entities that have or could have a direct or indirect effect on the institution's administrative capability or financial responsibility**, including but not limited to entities that:
  - ▶ Are sole member or hold 100% direct or indirect equity or voting interest;
  - ▶ Hold less than a 100% interest but otherwise exercise substantial control over the institution (which is any direct or indirect equity, membership, or voting interest of 50% or more); or
  - ▶ Provide the audited financial statements or other financial submissions on behalf of the institution.

# Title IV PPA Signatories: Entities (cont.)

- ▶ Under current EA policy, upper-level entity cosigning **presumptively required**:
  - ▶ Following a change of ownership;
  - ▶ Provisional certification status;
  - ▶ Financial responsibility composite score below 1.5;
  - ▶ Heightened Cash Monitoring Type 2 status;
  - ▶ Significant number of borrower defense or false certification claims;
  - ▶ Systemic or significant audit or program review findings, or unpaid liabilities; or
  - ▶ Institution or any of its principals or interest holders has consented to or has a judgment of fraud or misrepresentation entered against it by a federal or state court, foreign tribunal, or arbitration body.

# Title IV PPA Signatories: Entities (cont.)

- ▶ **Proposed Title IV Certification regulations** would require PPA co-signing from authorized representatives of **all entities with direct or indirect ownership and that exercise control over a proprietary or nonprofit institution**, including where an entity:
  - ▶ Has at least 50 percent control over the institution through direct or indirect ownership, by voting rights, by its right to appoint board members to the institution or any other entity, whether by itself or in combination with other entities or natural persons with which it is affiliated or related, or pursuant to a proxy or voting or similar agreement;
  - ▶ Has the power to block significant actions;
  - ▶ Is the 100 percent direct or indirect interest holder of the institution; or
  - ▶ Provides or will provide the financial statements upon which ED will assess financial responsibility.

# Title IV PPA Signatories: Individuals

- ▶ Electronic Announcement GENERAL-23-11 (March 1, 2023)
- ▶ **Individuals with substantial control** may be required to assume personal liability for Title IV program losses (through PPA cosigning) where the institution:
  - ▶ Has been subject to a limitation, suspension, or termination action within the preceding 5 years;
  - ▶ Has had, in the two most recent Title IV compliance audits, findings that resulted in repayments greater than 5% of the institution's Title IV receipts;
  - ▶ Has not met financial responsibility requirements in each of its preceding 5 fiscal years; or
  - ▶ Has been cited during the preceding 5 years for a failure to timely submit Title IV audits.

# Title IV PPA Signatories: Individuals (cont.)

- ▶ An individual with **substantial control**:
  - ▶ Directly or indirectly controls a “substantial ownership interest;”
  - ▶ Either alone or together with other individuals, represents, under a voting trust, power of attorney, proxy, or similar agreement, one or more persons who have, individually or in combination with the other persons represented or the individual representing them, a substantial ownership interest; or
  - ▶ Is a member of the board of directors, the chief executive officer, or other executive officer of the institution or of an entity that holds a substantial ownership interest.
- ▶ ED may accept “other financial protections” in lieu of co-signing on a case-by-case basis.



# Financial Responsibility: Changes in Ownership

- ▶ **Proposed Financial Responsibility regulations** would repeal and reserve all of 34 CFR § 668.15 (mostly dormant except for financial ratios applied to SDBS).
- ▶ Proposed new 34 CFR § 668.176 would codify SDBS financial ratios for changes in ownership, letter of credit requirements for transactions involving buyers without acceptable historic financial statements, and certain standards for buyer financial statements.
- ▶ Proposed regulations would also provide that an institution is not financially responsible following a change in control if the amount of debt assumed by the institution to complete the transaction requires payments (either periodic or balloon) that are inconsistent with available cash to service those payments.

# Financial Responsibility: Proposed New Mandatory Triggers

- ▶ Lawsuits by Federal or State authorities for fines, penalties or other financial relief, or qui tam actions where the federal government intervenes, which have been pending for 120 days.
- ▶ An institution with a composite score below 1.5 incurs a subsequent debt or other liability that, if retroactively applied to the prior fiscal year composite score, causes the recalculated composite score to be below 1.0.
- ▶ ED initiates an action to recover losses from approved Borrower Defense to Repayment claims, and the potential amount of such recovery causes the institution's composite score on a recalculated basis to fall below 1.0.
- ▶ At least 50% of the institution's Title IV funds are for programs that fail the Gainful Employment metrics for program eligibility.

# Financial Responsibility: Proposed New Mandatory Triggers (cont.)

- ▶ A state authorizing agency cites the institution for failing to meet that agency's requirements and such failure could result in withdrawal or termination of the institution's authorization. *(Note: this is a current discretionary trigger)*
- ▶ The institution loses eligibility to participate in another Federal education assistance program.
- ▶ Any regulatory oversight body requires the institution to submit teach-out plan or teach-out agreement.
- ▶ The institution has Cohort Default Rates for two consecutive years of 30% or more. *(Note: this is a current discretionary trigger)*
- ▶ A proprietary institution fails to comply with the 90/10 rule in a single fiscal year. *(Note: this is a current discretionary trigger)*
- ▶ The institution is subject to a default or other adverse condition under a credit or financing agreement as a result of actions taken by ED.

# Financial Responsibility: Proposed New Mandatory Triggers (cont.)

- ▶ The institution declares a financial exigency.
- ▶ The institution, or an owner or an affiliate of the institution that has the power, by contract or ownership interest, to direct or cause direction of the management of policies of the institution, files for a receivership.
- ▶ Contributions in final quarter of the institution's fiscal year, followed by distributions during the first or second quarter of the subsequent fiscal year, where the removal of such contribution from the composite score calculation causes a recalculated composite score below 1.0.
- ▶ With limited exceptions, a proprietary institution has a composite score below 1.5 and there is a withdrawal of owner's equity by any means, including through the declaration of a dividend, which would cause the institution's composite score on a recalculated basis to fall below 1.0.

# Financial Responsibility: Proposed New Discretionary Triggers

- ▶ An accrediting agency or other regulator places the institution on probation, show cause or a comparable status.
- ▶ The institution is subject to a default or other adverse condition under a credit or financing agreement unrelated to any actions by ED.
- ▶ Any judgment against the institution awarding monetary relief that is subject to or under appeal.
- ▶ The institution has high annual dropout rates, as calculated by ED.
- ▶ Significant fluctuations in Title IV funds received by the institution.
- ▶ The institution is under prior financial reporting obligations to ED and has any of the following occurrences: negative cash flows, failure of other liquidation ratios, cash flows that significantly miss projections, significantly increased withdrawal rates, or other indicators of a material change in the institution's financial condition.

# Financial Responsibility: Proposed New Discretionary Triggers (cont.)

- ▶ There are pending group-based Borrower Defense to Repayment claims involving students or former students of the institution.
- ▶ The institution discontinues programs enrolling more than 25% of its students.
- ▶ The institution closes more than 50% of its locations, or locations that enroll more than 25% of its students.
- ▶ A state authorizing agency cites the institution for failing to meet that agency's requirements.
- ▶ The institution is cited and faces loss of education assistance funds from another Federal agency if it does not comply with the agency's requirements.
- ▶ One or more of the institution's programs loses eligibility to participate in another Federal educational assistance program.
- ▶ If the institution is directly or indirectly owned at least 50 percent by publicly traded entity, that publicly traded entity discloses in a public filing that it is under investigation for possible violations of law.

# Financial Responsibility: Other Proposed Rule Provisions

- ▶ Proposed regulations make clear that a **separate letter of credit requirement of no less than 10% of the institution's prior year Title IV receipts arises from each mandatory or discretionary triggering event**. This means that institutions with multiple triggering events may be subject to substantial cumulative letter of credit obligations.
- ▶ Proposed regulations include additional factual circumstances that would deem an institution not financially responsible:
  - ▶ Failing to make timely refunds or returns of Title IV funds.
  - ▶ Failing to make repayments of any Title IV liabilities.
  - ▶ Failing to make payments on an undisputed financial obligation for more than 90 days.
  - ▶ Failing to satisfy payroll obligations in accordance with its published payroll schedule.
  - ▶ Borrowing funds from retirement plans or restricted funds without appropriate authorization.

# Additional Resources

## McClintock Minute



<https://www.mcclintockcpa.com/mcclintock-minute>

## Faegre Drinker Insights



<https://cloud.faegredrinkerupdates.com/subscribe>



# Thank You!

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