June 29, 2021

Ms. Vanessa Gomez
U.S. Department of Education
400 Maryland Avenue SW
Room 2C179
Washington, DC 20202

Re: Docket ID ED-2021-OPE-0077

Dear Ms. Gomez:

The National Association of Independent Colleges and Universities (NAICU), the National Association of College and University Business Officers (NACUBO), and the American Council on Education (ACE) appreciates the opportunity to jointly comment on the Department of Education's (Department) intent to establish negotiated rulemaking committees published in the Federal Register on May 26, 2021 to develop proposed regulations on the affordability of postsecondary education, institutional accountability, and Federal student loans.

NAICU serves as the unified voice for the more than 1,700 private, nonprofit colleges and universities in our nation including major research universities; faith-based colleges; Historically Black Colleges and Universities; Minority-Serving Institutions; art and design colleges; traditional liberal arts institutions; science institutions; women's colleges; work colleges; two-year colleges; and schools of law, medicine, engineering, business and other professions. NACUBO represents college and university business officers at more than 1,600 public and nonprofit colleges and universities with a mission to advance the economic vitality, business practices, and support of higher education institutions in pursuit of their missions. As the major coordinating body for the nation's colleges and universities, ACE mobilizes the higher education community to shape effective public policy and foster innovative, high-quality practice. ACE's diverse membership includes more than 1,700 colleges and universities, related associations, and other organizations in America and abroad, and ACE is the only major presidential higher education association to represent all types of U.S. accredited, degree-granting institutions.

The proposed rulemaking agenda covers a broad scope of issues in the higher education sphere that we have interest in, but we are particularly pleased that the Department has chosen to include a review of the current Financial Responsibility Standards (FRS) on the agenda and wish to comment specifically on that matter given its particular importance to our members.

At its core, these standards are meant to protect students and taxpayers from precipitous institutional closures. The current system has proven a poor tool toward that end by penalizing many institutions that are healthy, while failing to identify those that are not.

We believe the upcoming regulatory review should examine the larger purpose of this assessment of financial viability and be ready to propose systemic change to ensure its primary purpose is being fulfilled. For example, as we reflect on the lessons from the pandemic and other

national emergencies, among the most important issues for negotiators to consider is how a system can be adaptable and help during an emergency, rather than increasing distress. Good public policy should anticipate the unexpected as both Congress and the Department have already done in areas such as federal student aid. Without these flexibilities, a strong financial responsibility system can suddenly weaken and be undermined.

We would be pleased to collaborate with the Department as to how this system might best be improved in a holistic, efficient, and effective manner. In addition, within the current financial responsibility mechanism, we want to highlight three areas that we hope the upcoming negotiated rulemaking process will address: the financial responsibility process, review of composite score calculations, and calculation of long-term debt.

FRS Process

A decade ago, NAICU and NACUBO, along with a number of experts in the field, to issue the *Report of the NAICU Financial Responsibility Task Force*. A key set of recommendations from that report focused on the need to update some of the processes around the federal financial responsibility system to provide for more accuracy and fairness in the system. Currently there is too little correlation between the FRS ratio and the risk of closure for private, nonprofit institutions.

The process itself must be fixed to include a more holistic look at an institution's overall financial situation before assessing penalties or corrective actions – and allow for an evaluation or appeals process when an institution's finances change.

Several important steps could be taken within the current construct of the law and include:

- Creating a course of action that includes providing a draft composite score to each institution before final composite scores are created, similar to the process that exists for federal default rate calculations. This could help avoid situations such as when the 2017-2018 composite scores were first released by the Department and had to be pulled from public view because of a series of mistakes that were found by institutions; and

- Consideration of an institution's total financial circumstances before requiring it to post a letter of credit. This is particularly important to students and taxpayers since the ratio, by its nature, is a lagging indicator. While we agree that letters of credit can help protect taxpayers in the case of the precipitous closure of an institution, non-profit institutions rarely if ever precipitously close; nonprofits are accountable to donors and attorneys general for restricted contributions and endowments, respectively. Consequently, letters of credit from private non-profit colleges can be a significant and costly waste of institutional resources. Consideration of the total current financial resources of an institution would allow the Department to assess the real risk an institution poses to taxpayers and could also address the problem with lagging indicators of several years in the current methodology.

Review of Composite Score Calculations

The Higher Education Act (HEA) Amendments of 1976 lead the then-Commissioner of Education to establish Financial Responsibility Standards. That system was redone as a result of the 1992 HEA reauthorization with final regulations implemented in 1997. It has been nearly 25 years since the current standards were fully revised and those standards no longer reflect the changing nature of higher education finances.

Despite the fact that we believe the challenges to the current system cannot be fixed by simply adjusting ratio components, we are thankful for recent updates to the composite score that included corrected treatment of defined benefit pensions and endowments.

But a more comprehensive review of the composite score (if it is continued to be used) needs to be conducted. Just as the Department cited the need for the pre-1997 standards to be updated to properly address evolving accounting, financial, and operating characteristics, the same is needed again, especially in light of the recent pandemic.

Calculation of Long-Term Debt

To emphasize one issue in particular that is of urgent importance, the Department's recent update of some key ratio components tried to address the concern that some institutions were manipulating their composite scores by taking on lines of credit to take advantage of long-term debt benefits in the ratio calculation. However, we now see new problems emerging with the primary reserve ratio because of this change. Perfectly healthy institutions are projecting lowered or failing composite scores because they made the appropriate business decision to refinance outstanding debt to take advantage of historically low interest rates. Such refinancing resulted in real cost savings for the benefit of students and educational activities.

More specifically, institutions that refinance their debt for a better interest rate are not allowed to count the full value of the refinanced debt as qualified long-term debt if proceeds of the new debt exceed the amount refinanced, even if the debt is associated with property, plant, and equipment (PP&E). There are a number of reasons cash proceeds may exceed the book value of refinanced debt. However, the association of par-value to PP&E in order to derive an institution's investment in its plant should be considered in the primary reserve ratio. Debt and its relationship to the plant (or campus) is primarily relevant to nonprofit colleges and universities due to significant amounts of PP&E.

For example, if an institution chooses to refinance allowable long-term debt that is $10 million for an amount that is $30 million, in order to finance the construction of a facility for $20 million, the debt may be denied because it will take the institution 12 months (the next operating cycle) to build the project. Even if the institution has partially built $3 million worth of construction, future construction ($20 million less the $3 million in progress) does not qualify as PP&E, so the entire debt of $30 million would be disallowed. A more accurate calculation would reflect the economic substance of the refinance and allow the par-value of all debt associated with existing plant ($10 million) and the new construction in progress ($3 million), and exclude excess cash received from the refinance, from the ratio calculation.

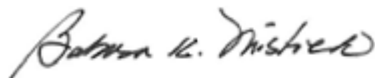
Consider a second example, where existing allowable long-term debt of $15 million is refinanced for a lower interest rate that is reflected through a $1 million premium. The proceeds from the refinance would be $16 million ($15 million plus the $1 million premium) but the entire amount of the debt would be disallowed because the refinance proceeds exceed the original $15 million, even though the premium is essentially a cash interest rate rebate that reduces interest costs over the life of the debt instrument. In this case, as in the first example, the par-value of the debt reflects the economic substance of the transaction and should be used in the ratio calculation.

The current rule leaves institutions that captured recent historic low interest rates, and are not at risk of closure, facing failing or reduced FRS scores. Institutions should be encouraged to make the best financial decisions to provide the most effective operational support for students, faculty, and staff. Instead, they are being penalized.

Conclusion

We commend the Department for including FRS as an area of consideration during a negotiated rulemaking session. We offer our full support to the Department to further examine the current standards to ensure that they are indeed working optimally for institutions, students, and taxpayers. The areas we have outlined in this letter serve as our primary concerns but should not be taken as an exhaustive list. There are many more nuanced areas of the system that can be modified and improved, and we would welcome the opportunity to discuss those with the Department further during the rulemaking process. We thank you for your consideration and would be pleased to provide any additional information that might be helpful to you.

Sincerely,



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