



Keeping Up with Changes to Federal Regulations on Changes in Ownership and Financial Responsibility

Jonathan Tarnow, Esq. | Faegre Drinker Biddle & Reath LLP

David McClintock, CPA | McClintock & Associates, P.C.

Disclaimers

- This presentation is provided for informational purposes only.
- All views expressed in this presentation, or during the accompanying discussion, are solely those of the presenters.
- The contents of this presentation and the accompanying discussion do not constitute legal or accounting advice.
- No party should act or refrain from acting on the basis of this presentation without seeking individualized legal counsel or accounting representation.
- The contents of this presentation should not be redistributed or republished without consent.

Some Key Resources

- ED final regulations published 10/28/2022 and effective 7/1/2023
- ED proposed regulations on both Financial Responsibility and Title IV Certification Procedures (expected April 2023)
- ED Electronic Announcement (“EA”) GENERAL-22-70 (9/15/2022) “Updated Guidance and Procedures for Changes in Ownership”
- ED EA GENERAL-22-16 (3/23/2022) “Updated Program Participation Agreement Signature Requirements for Entities Exercising Substantial Control Over Non-Public Institutions of Higher Education”
- ED EA GENERAL-23-11 (3/1/2023) “Establishing Personal Liability Requirements for Financial Losses Related to the Title IV Programs”

Why Changes Were Made (per ED)

- Change in ownership and/or control transactions growing in complexity
- Most concerned about transactions that convert for-profit institution to nonprofit
 - Reviewing these transactions have been taking as long as a year
 - Being in limbo was putting pressure on institutions and ED
- Desire more streamlined process that ensures compliance with regulations
- Changes intended to provide ED with adequate notice to evaluate transactions before they occur

Topics to be Covered

- Title IV eligibility and CIO
- Identifying changes 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 or 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 additional location for another Title IV institution
- Required 90-day notifications prior to CIO

Topics to be Covered (cont.)

- “Materially complete” application requirements
- Maintaining the Temporarily Provisional Program Participation Agreement following a change in ownership and control
- Post-transaction conditions from ED
- ED pre-acquisition review
- New reporting of ownership changes that are not a change in control
- Title IV Program Participation Agreement signatories
- Expected additional Financial Responsibility mandatory triggers

Title IV Eligibility and Changes in Ownership

- Institution that undergoes a **change in ownership that results in a change in control** ceases to qualify as a Title IV eligible institution upon the change in ownership and control, unless the institution submits a “materially complete” change in ownership application to ED within 10 business days following the change.
- ED standards for changes in ownership and control requiring its approval for Title IV purposes do not always align with applicable state and/or accrediting requirements.
- If a transaction triggers ED approval requirements, institution must obtain any required state and/or accrediting approvals consistent with Title IV deadlines.

Identifying Changes Requiring ED Approval

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

Identifying Changes 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 or publicly-traded).
- Current standard for such “other entities” is effectively 25% and control.
- Generally changing “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.

Revised ED 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 acquires or ceases 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.

Revised ED 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.

Revised ED 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%.

Revised ED 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)

- 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 is **generally 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.

Acquisitions Involving a Title IV Institution Becoming an Additional 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.

Required Notifications Before Change

- Under final regulations effective 7/1/2023, 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.”)

“Materially Complete” Application

- Required submission to ED 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 for the **two most recently completed fiscal years** of both the institution and the proposed new owner (this is no longer satisfied with only the two most recent fiscal years for which audits are available).

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.
- SDBS typically due last day of the month following the month CIO occurs
- Extended deadlines under Covid-19 national emergency for institutions to provide ED with state and accrediting approvals are expiring soon
 - State and accrediting approvals of transactions will again be needed within 30-60 days following the transaction closing date.

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 from ED

- Final 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 from ED (cont.)

- **Proposed Financial Responsibility regulations (expected April 2023)** are anticipated to 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 from ED (cont.)

- **Proposed Title IV Certification regulations (expected April 2023)** are anticipated to 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.

ED Pre-Acquisition Review

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

Reporting Other Ownership Changes

- Final 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 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.

Title IV PPA Signatories

- Changes in ownership resulting in changes of control result in new Title IV certification with a new Program Participation Agreement.
- ED proposed new PPA cosigning requirements during its 2022 negotiated rulemaking on “Institutional and Programmatic Eligibility,” for which there was not consensus.
- Proposed regulations on Title IV Certification expected April 2023.
- In the meantime, ED has issued two Electronic Announcements on PPA cosigning affecting both ownership entities and individuals.

Title IV PPA Signatories – Entities

- Electronic Announcement GENERAL-22-16 (March 23, 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.)

- Electronic Announcement GENERAL-22-16 (March 23, 2022)
- Effective July 1, 2022, **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 – 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.)

- Electronic Announcement GENERAL-23-11 (March 1, 2023):
- **Individuals with substantial control:**
 - Directly or indirectly controls a “substantial ownership interest” in the institution;
 - 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 in the institution; or
 - 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 in the institution.
- ED may accept “other financial protections” on a case-by-case basis.

Financial Responsibility Mandatory Triggers

- **Proposed Financial Responsibility regulations (expected April 2023)** anticipated to revise **mandatory triggers** that require institutions to post letter(s) of credit, including but not limited to:
 - Legal proceedings which could result in composite score below 1.0.
 - Lawsuits from governmental agencies pending for more than 120 days.
 - Borrower Defense claims exceeding 5% of Title IV receipts.
 - Notice from state or accrediting agencies of violations that could lead to loss of authorization or accreditation.
 - Creditor terminates, withdraws, limits or suspends financing arrangement, or calls due balance on any line of credit.

Financial Responsibility Mandatory Triggers (cont.)

- Anticipated revised mandatory triggers (continued):
 - Institution is required to submit a teach-out plan and/or agreement (including for any branch or additional location).
 - Loss of institutional eligibility to participate in another Federal educational assistance program.
 - Equity distributions made in first two quarters of fiscal year up to total equity contributions made in last quarter of previous fiscal year resulting in recalculated composite score below 1.0.
 - Failures of 90/10, Gainful Employment or Cohort Default Rate thresholds.
 - Occurrence of two of more discretionary financial responsibility triggers.

Financial Responsibility Discretionary Triggers

- **Proposed Financial Responsibility regulations (expected April 2023)** anticipated to revise **discretionary triggers** that could require institutions to post letter(s) of credit, including but not limited to:
 - State agency citations under licensure/authorization requirements.
 - Accrediting actions including probation, show cause or equivalent.
 - Creditor events (subject to a default) resulting in change in collateral, interest rate, fees, contractual obligation, etc.
 - ED initiates a Borrower Defense group claim progress.
 - Loss of program-level eligibility to participate in another Federal educational assistance program.

Financial Responsibility Discretionary Triggers (cont.)

- Anticipated revised **discretionary triggers** (continued):
 - Discontinuation of programs affecting 25% of students.
 - Closure of most ground-based locations (even if maintaining online).
 - Significant fluctuations in Title IV volume.
 - High annual dropout rates.
 - Short-term borrowing under loan or line of credit in last quarter of fiscal year and repaid during first two quarters of next fiscal year.
 - For institutions on interim financial reporting: negative cash flows, failure of other liquidation ratios, cash flows that significantly miss the projections submitted to ED, or withdrawal rates that increase significantly, or other indicators of a material change in the financial condition of the institution.

Additional Resources

McClintock Minute



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

Faegre Drinker Alerts and Insights



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



Questions?

2023 NASASPS Annual Conference

April 30 – May 3 | Phoenix, Arizona



Thank you!

Jonathan Tarnow | 202.354.1357 | Jonathan.Tarnow@faegredrinker.com

David McClintock | 412.838.0206 | DMcClintock@Mcclintockcpa.com