**Issue 5 –** **Financial Responsibility for Participating Institutions of Higher Education**

**34 CFR 668.15 – Factors of financial responsibility**

§ **668.15 – Factors of Financial Responsibility**

(a) *General.* To begin and to continue to participate in any Title IV, HEA program, an institution must demonstrate to the Secretary that the institution is financially responsible under the requirements established in this section.

Terms Used In 34 CFR 668.15

* **Assets**: (1) The property comprising the estate of a deceased person, or (2) the property in a trust account.
* **Corporation**: A legal entity owned by the holders of shares of stock that have been issued, and that can own, receive, and transfer property, and carry on business in its own name.
* **Fiscal year**: The fiscal year is the accounting period for the government. For the federal government, this begins on October 1 and ends on September 30. The fiscal year is designated by the calendar year in which it ends; for example, fiscal year 2006 begins on October 1, 2005 and ends on September 30, 2006.
* **Guarantor**: A party who agrees to be responsible for the payment of another party's debts should that party default. Source: OCC
* **Liabilities**: The aggregate of all debts and other legal obligations of a particular person or legal entity.
* **Obligation**: An order placed, contract awarded, service received, or similar transaction during a given period that will require payments during the same or a future period.
* **Partnership**: A voluntary contract between two or more persons to pool some or all of their assets into a business, with the agreement that there will be a proportional sharing of profits and losses.
* **Power of attorney**: A written instrument which authorizes one person to act as another's agent or attorney. The power of attorney may be for a definite, specific act, or it may be general in nature. The terms of the written power of attorney may specify when it will expire. If not, the power of attorney usually expires when the person granting it dies. Source: OCC
* **Settlement**: Parties to a lawsuit resolve their difference without having a trial. Settlements often involve the payment of compensation by one party in satisfaction of the other party's claims.

(b) *General standards of financial responsibility.* In general, the Secretary considers an institution to be financially responsible only if it –

(1) Is providing the services described in its official publications and statements;

(2) Is providing the administrative resources necessary to comply with the requirements of this subpart;

(3) Is meeting all of its financial obligations, including but not limited to –

(i) Refunds that it is required to make; and

(ii) Repayments to the Secretary for liabilities and debts incurred in programs administered by the Secretary;

(4) Is current in its debt payments. The institution is not considered current in its debt payments if –

(i) The institution is in violation of any existing loan agreement at its fiscal year end, as disclosed in a note to its audited financial statement; or

(ii) the institution fails to make a payment in accordance with existing debt obligations for more than 120 days, and at least one creditor has filed suit to recover those funds;

(5) Except as provided in paragraph (d) of this section, in accordance with procedures established by the Secretary, submits to the Secretary an irrevocable letter of credit, acceptable and payable to the Secretary equal to 25 percent of the total dollar amount of Title IV, HEA program refunds paid by the institution in the previous fiscal year;

(6) Has not had, as part of the audit report for the institution’s most recently completed fiscal year –

(i) A statement by the accountant expressing substantial doubt about the institution’s ability to continue as a going concern; or

(ii) A disclaimed or adverse opinion by the accountant;

(7) For a for-profit institution –

(i)(A) Demonstrates at the end of its latest fiscal year, an acid test ratio of at least 1:1. For purposes of this section, the acid test ratio shall be calculated by adding cash and cash equivalents to current accounts receivable and dividing the sum by total current liabilities. The calculation of the acid test ratio shall exclude all unsecured or uncollateralized related party receivables;

(B) Has not had operating losses in either or both of its two latest fiscal years that in sum result in a decrease in tangible net worth in excess of 10 percent of the institution’s tangible net worth at the beginning of the first year of the two-year period. The Secretary may calculate an operating loss for an institution by excluding from net income: extraordinary gains or losses; income or losses from discontinued operations; prior period adjustment; and, the cumulative effect of changes in accounting principle. For purposes of this section, the calculation of tangible net worth shall exclude all assets defined as intangible in accordance with generally accepted accounting principles; and

(C) Had, for its latest fiscal year, a positive tangible net worth. In applying this standard, a positive tangible net worth occurs when the institution’s tangible assets exceed its liabilities. The calculation of tangible net worth shall exclude all assets classified as intangible in accordance with the generally accepted accounting principles; or

(ii) Demonstrates to the satisfaction of the Secretary that it has currently issued and outstanding debt obligations that are (without insurance, guarantee, or credit enhancement) listed at or above the second highest rating level of credit quality given by a nationally recognized statistical rating organization;

(8) For a nonprofit institution –

(i)(A) Prepares a classified statement of financial position in accordance with generally accepted accounting principles or provides the required information in notes to the audited financial statements;

(B) Demonstrates at the end of its latest fiscal year, an acid test ratio of at least 1:1. For purposes of this section, the acid test ratio shall be calculated by adding cash and cash equivalents to current accounts receivable and dividing the sum by total current liabilities. The calculation of the acid test ratio shall exclude all unsecured or uncollateralized related party receivables.

(C)(*1*) Has, at the end of its latest fiscal year, a positive unrestricted current fund balance or positive unrestricted net assets. In calculating the unrestricted current fund balance or the unrestricted net assets for an institution, the Secretary may include funds that are temporarily restricted in use by the institution’s governing body that can be transferred to the current unrestricted fund or added to net unrestricted assets at the discretion of the governing body; or

(*2*) Has not had, an excess of current fund expenditures over current fund revenues over both of its 2 latest fiscal years that results in a decrease exceeding 10 percent in either the unrestricted current fund balance or the unrestricted net assets at the beginning of the first year of the 2-year period. The Secretary may exclude from net changes in fund balances for the operating loss calculation: Extraordinary gains or losses; income or losses from discontinued operations; prior period adjustment; and the cumulative effect of changes in accounting principle. In calculating the institution’s unrestricted current fund balance or the unrestricted net assets, the Secretary may include funds that are temporarily restricted in use by the institution’s governing body that can be transferred to the current unrestricted fund or added to net unrestricted assets at the discretion of the governing body; or

(ii) Demonstrates to the satisfaction of the Secretary that it has currently issued and outstanding debt obligations which are (without insurance, guarantee, or credit enhancement) listed at or above the second highest rating level of credit quality given by a nationally recognized statistical rating organization.

(9) For a public institution –

(i) Has its liabilities backed by the full faith and credit of a State, or by an equivalent governmental entity;

(ii) Has a positive current unrestricted fund balance if reporting under the Single Audit Act;

(iii) Has a positive unrestricted current fund in the State’s Higher Education Fund, as presented in the general purpose financial statements;

(iv) Submits to the Secretary, a statement from the State Auditor General that the institution has, during the past year, met all of its financial obligations, and that the institution continues to have sufficient resources to meet all of its financial obligations; or

(v) Demonstrates to the satisfaction of the Secretary that it has currently issued and outstanding debt obligations which are (without insurance, guarantee, or credit enhancement) listed at or above the second highest rating level of credit quality given by a nationally recognized statistical rating organization.

(c) *Past performance of an institution or persons affiliated with an institution.* An institution is not financially responsible if –

(1) A person who exercises substantial control over the institution or any member or members of the person’s family alone or together –

(i)(A) Exercises or exercised substantial control over another institution or a third-party servicer that owes a liability for a violation of a Title IV, HEA program requirement; or

(B) Owes a liability for a violation of a Title IV, HEA program requirement; and

(ii) That person, family member, institution, or servicer does not demonstrate that the liability is being repaid in accordance with an agreement with the Secretary; or

(2) The institution has –

(i) Been limited, suspended, terminated, or entered into a settlement agreement to resolve a limitation, suspension, or termination action initiated by the Secretary or a guaranty agency (as defined in [34 CFR part 682](https://www.lawserver.com/law/country/us/cfr/34_cfr_part_682)) within the preceding five years;

(ii) Had –

(A) An audit finding, during its two most recent audits of its conduct of the Title IV, HEA programs, that resulted in the institution’s being required to repay an amount greater than five percent of the funds that the institution received under the Title IV, HEA programs for any award year covered by the audit; or

(B) A program review finding, during its two most recent program reviews, of its conduct of the Title IV, HEA programs that resulted in the institution’s being required to repay an amount greater than five percent of the funds that the institution received under the Title IV, HEA programs for any award year covered by the program review;

(iii) Been cited during the preceding five years for failure to submit acceptable audit reports required under this part or individual Title IV, HEA program regulations in a timely fashion; or

(iv) Failed to resolve satisfactorily any compliance problems identified in program review or audit reports based upon a final decision of the Secretary issued pursuant to subpart G or subpart H of this part.

(d) *Exceptions to the general standards of financial responsibility.* (1)(i) An institution is not required to meet the standard in paragraph (b)(5) of this section if the Secretary determines that the institution –

(A)(*1*) Is located in, and is legally authorized to operate within, a State that has a tuition recovery fund that is acceptable to the Secretary and ensures that the institution is able to pay all required refunds; and

(*2*) Contributes to that tuition recovery fund.

(B) Has its liabilities backed by the full faith and credit of the State, or by an equivalent governmental entity; or

(C) As determined under paragraph (g) of this section, demonstrates, to the satisfaction of the Secretary, that for each of the institution’s two most recently completed fiscal years, it has made timely refunds to students in accordance with § 668.22(j), and that it has met or exceeded all of the financial responsibility standards in this section that were in effect for the corresponding periods during the two-year period.

(ii) In evaluating an application to approve a State tuition recovery fund to exempt its participating schools from the Federal cash reserve requirements, the Secretary will consider the extent to which the State tuition recovery fund:

(A) Provides refunds to both in-state and out-of-state students;

(B) Allocates all refunds in accordance with the order delineated in § 668.22(i); and

(C) Provides a reliable mechanism for the State to replenish the fund should any claims arise that deplete the funds assets.

(2) The Secretary considers an institution to be financially responsible, even if the institution is not otherwise financially responsible under paragraphs (b)(1) through (4) and (b)(6) through (9) of this section, if the institution –

(i) Submits to the Secretary an irrevocable letter of credit that is acceptable and payable to the Secretary equal to not less than one-half of the Title IV, HEA program funds received by the institution during the last complete award year for which figures are available; or

(ii) Establishes to the satisfaction of the Secretary, with the support of a financial statement submitted in accordance with paragraph (e) of this section, that the institution has sufficient resources to ensure against its precipitous closure, including the ability to meet all of its financial obligations (including refunds of institutional charges and repayments to the Secretary for liabilities and debts incurred in programs administered by the Secretary). The Secretary considers the institution to have sufficient resources to ensure against precipitous closure only if –

(A) The institution formerly demonstrated financial responsibility under the standards of financial responsibility in its preceding audited financial statement (or, if no prior audited financial statement was requested by the Secretary, demonstrates in conjunction with its current audit that it would have satisfied this requirement), and that its most recent audited financial statement indicates that –

(*1*) All taxes owed by the institution are current;

(*2*) The institution’s net income, or a change in total net assets, before extraordinary items and discontinued operations, has not decreased by more than 10 percent from the prior fiscal year, unless the institution demonstrates that the decreased net income shown on the current financial statement is a result of downsizing pursuant to a management-approved business plan;

(*3*) Loans and other advances to related parties have not increased from the prior fiscal year unless such increases were secured and collateralized, and do not exceed 10 percent of the prior fiscal year’s working capital of the institution;

(*4*) The equity of a for-profit institution, or the total net assets of a non-profit institution, have not decreased by more than 10 percent of the prior year’s total equity;

(*5*) Compensation for owners or other related parties (including bonuses, fringe benefits, employee stock option allowances, 401k contributions, deferred compensation allowances) has not increased from the prior year at a rate higher than for all other employees;

(*6*) The institution has not materially leveraged its assets or income by becoming a guarantor on any new loan or obligation on behalf of any related party;

(*7*) All obligations owed to the institution by related parties are current, and that the institution has demanded and is receiving payment of all funds owed from related parties that are payable upon demand. For purposes of this section, a person does not become a related party by attending an institution as a student;

(B) There have been no material findings in the institution’s latest compliance audit of its administration of the Title IV HEA programs; and

(C) There are no pending administrative or legal actions being taken against the institution by the Secretary, any other Federal agency, the institution’s nationally recognized accrediting agency, or any State entity.

(3) An institution is not required to meet the acid test ratio in paragraph (b)(7)(i)(A) or (b)(8)(i)(B) of this section if the institution is an institution that provides a 2-year or 4-year educational program for which the institution awards an associate or baccalaureate degree that demonstrates to the satisfaction of the Secretary that –

(i) There is no reasonable doubt as to its continued solvency and ability to deliver quality educational services;

(ii) It is current in its payment of all current liabilities, including student refunds, repayments to the Secretary, payroll, and payment of trade creditors and withholding taxes; and

(iii) It has substantial equity in institution-occupied facilities, the acquisition of which was the direct cause of its failure to meet the acid test ratio requirement.

(4) The Secretary may determine an institution to be financially responsible even if the institution is not otherwise financially responsible under paragraph (c)(1) of this section if –

(i) The institution notifies the Secretary, in accordance with [34 CFR 600.30](https://www.lawserver.com/law/country/us/cfr/34_cfr_600-30), that the person referenced in paragraph (c)(1) of this section exercises substantial control over the institution; and

(ii)(A) The person repaid to the Secretary a portion of the applicable liability, and the portion repaid equals or exceeds the greater of –

(*1*) The total percentage of the ownership interest held in the institution or third-party servicer that owes the liability by that person or any member or members of that person’s family, either alone or in combination with one another;

(*2*) The total percentage of the ownership interest held in the institution or servicer that owes the liability that the person or any member or members of the person’s family, either alone or in combination with one another, represents or represented under a voting trust, power of attorney, proxy, or similar agreement; or

(*3*) Twenty-five percent, if the person or any member of the person’s family is or was a member of the board of directors, chief executive officer, or other executive officer of the institution or servicer that owes the liability, or of an entity holding at least a 25 percent ownership interest in the institution that owes the liability;

(B) The applicable liability described in paragraph (c)(1) of this section is currently being repaid in accordance with a written agreement with the Secretary; or

(C) The institution demonstrates why –

(*1*) The person who exercises substantial control over the institution should nevertheless be considered to lack that control; or

(*2*) The person who exercises substantial control over the institution and each member of that person’s family nevertheless does not or did not exercise substantial control over the institution or servicer that owes the liability.

(e) [Reserved]

(f) *Definitions and terms.* For the purposes of this section –

(1)(i) An ownership interest is a share of the legal or beneficial ownership or control of, or a right to share in the proceeds of the operation of, an institution, institution’s parent corporation, a third-party servicer, or a third-party servicer’s parent corporation.

(ii) The term ownership interest includes, but is not limited to –

(A) An interest as tenant in common, joint tenant, or tenant by the entireties;

(B) A partnership; and

(C) An interest in a trust.

(iii) The term ownership interest does not include any share of the ownership or control of, or any right to share in the proceeds of the operation of –

(A) A mutual fund that is regularly and publicly traded;

(B) An institutional investor; or

(C) A profit-sharing plan, provided that all employees are covered by the plan;

(2) The Secretary generally considers a person to exercise substantial control over an institution or third-party servicer, if the person –

(i) Directly or indirectly holds at least a 25 percent ownership interest in the institution or servicer;

(ii) Holds, together with other members of his or her family, at least a 25 percent ownership interest in the institution or servicer;

(iii) Represents, either alone or together with other persons, under a voting trust, power of attorney, proxy, or similar agreement one or more persons who hold, either individually or in combination with the other persons represented or the person representing them, at least a 25 percent ownership in the institution or servicer; or

(iv) Is a member of the board of directors, the chief executive officer, or other executive officer of –

(A) The institution or servicer; or

(B) An entity that holds at least a 25 percent ownership interest in the institution or servicer; and

(3) The Secretary considers a member of a person’s family to be a parent, sibling, spouse, child, spouse’s parent or sibling, or sibling’s or child’s spouse.

(g) *Two-year performance requirement.* (1) The Secretary considers an institution to have satisfied the requirements in paragraph (d)(1)(C) of this section if the independent certified public accountant, or government auditor who conducted the institution’s compliance audits for the institution’s two most recently completed fiscal years, or the Secretary or a State or guaranty agency that conducted a review of the institution covering those fiscal years –

(i)(A) For either of those fiscal years, did not find in the sample of student records audited or reviewed that the institution made late refunds to 5 percent or more of the students in that sample. For purposes of determining the percentage of late refunds under this paragraph, the auditor or reviewer must include in the sample only those title IV, HEA program recipients who received or should have received a refund under § 668.22; or

(B) The Secretary considers the institution to have satisfied the conditions in paragraph (g)(1)(i)(A) of this section if the auditor or reviewer finds in the sample of student records audited or reviewed that the institution made only one late refund to a student in that sample; and

(ii) For either of those fiscal years, did not note a material weakness or a reportable condition in the institution’s report on internal controls that is related to refunds.

(2) If the Secretary or a State or guaranty agency finds during a review conducted of the institution that the institution no longer qualifies for an exemption under paragraph (d)(1)(C) of this section, the institution must –

(i) Submit to the Secretary the irrevocable letter of credit required in paragraph (b)(5) of this section no later than 30 days after the Secretary or State or guaranty agency notifies the institution of that finding; and

(ii) Notify the Secretary of the guaranty agency or State that conducted the review.

(3) If the auditor who conducted the institution’s compliance audit finds that the institution no longer qualifies for an exemption under paragraph (d)(1)(C) of this section, the institution must submit to the Secretary the irrevocable letter of credit required in paragraph (b)(5) of this section no later than 30 days after the date the institution’s compliance audit must be submitted to the Secretary.

(h) *Foreign institutions.* The Secretary makes a determination of the financial responsibility for a foreign institution on the basis of financial statements submitted under § 668.23(h).

**Issue 5 – Financial Responsibility for Participating Institutions of Higher Education**

**Subpart L - Financial Responsibility**

**§ 668.171 General.**

(a) ***Purpose.*** To begin and to continue to participate in any title IV, HEA program, an institution must demonstrate to the Secretary that it is financially responsible under the standards established in this subpart. As provided under section 498(c)(1) of the HEA, the Secretary determines whether an institution is financially responsible based on the institution's ability to -

(1) Provide the services described in its official publications and statements;

(2) Meet all of its financial obligations; and

(3) Provide the administrative resources necessary to comply with title IV, HEA program requirements.

(b) ***General standards of financial responsibility.*** Except as provided under [paragraphs (c)](https://www.ecfr.gov/current/title-34/section-668.171#p-668.171(c)), [(d)](https://www.ecfr.gov/current/title-34/section-668.171#p-668.171(d)), and [(h)](https://www.ecfr.gov/current/title-34/section-668.171#p-668.171(h)) of this section, the Secretary considers an institution to be financially responsible if the Secretary determines that -

(1) The institution's Equity, Primary Reserve, and Net Income ratios yield a composite score of at least 1.5, as provided under [§ 668.172](https://www.ecfr.gov/current/title-34/section-668.172) and appendices A and B to this subpart;

(2) The institution has sufficient cash reserves to make required returns of unearned title IV, HEA program funds, as provided under [§ 668.173](https://www.ecfr.gov/current/title-34/section-668.173);

(3) The institution is able to meet all of its financial obligations and provide the administrative resources necessary to comply with title IV, HEA program requirements. An institution is not deemed able to meet its financial or administrative obligations if -

(i) It fails to make refunds under its refund policy or return title IV, HEA program funds for which it is responsible under [§ 668.22](https://www.ecfr.gov/current/title-34/section-668.22);

(ii) It fails to make repayments to the Secretary for any debt or liability arising from the institution's participation in the title IV, HEA programs; or

(iii) It is subject to an action or event described in [paragraph (c)](https://www.ecfr.gov/current/title-34/section-668.171#p-668.171(c)) of this section (mandatory triggering events), or an action or event that the Secretary determines is likely to have a material adverse effect on the financial condition of the institution under [paragraph (d)](https://www.ecfr.gov/current/title-34/section-668.171#p-668.171(d)) of this section (discretionary triggering events); and

(4) The institution or persons affiliated with the institution are not subject to a condition of past performance under [§ 668.174(a)](https://www.ecfr.gov/current/title-34/section-668.174#p-668.174(a)) or [(b)](https://www.ecfr.gov/current/title-34/section-668.174#p-668.174(b)).

(c) ***Mandatory triggering events.*** An institution is not able to meet its financial or administrative obligations under [paragraph (b)(3)(iii)](https://www.ecfr.gov/current/title-34/section-668.171#p-668.171(b)(3)(iii)) of this section if -

(1) After the end of the fiscal year for which the Secretary has most recently calculated an institution's composite score, one or more of the following occurs:

(i)

(A) The institution incurs a liability from a settlement, final judgment, or final determination arising from an administrative or judicial action or proceeding initiated by a Federal or State entity. A determination arising from an administrative action or proceeding initiated by a Federal or State entity means the determination was made only after an institution had notice and an opportunity to submit its position before a hearing official. A final determination arising from an administrative action or proceeding initiated by a Federal entity includes a final determination arising from any administrative action or proceeding initiated by the Secretary. For purposes of this section, the liability is the amount stated in the final judgment or final determination. A judgment or determination becomes final when the institution does not appeal or when the judgment or determination is not subject to further appeal; or

(B) For a proprietary institution whose composite score is less than 1.5, there is a withdrawal of owner's equity from the institution by any means (*e.g.,* a capital distribution that is the equivalent of wages in a sole proprietorship or partnership, a distribution of dividends or return of capital, or a related party receivable), unless the withdrawal is a transfer to an entity included in the affiliated entity group on whose basis the institution's composite score was calculated; and

(ii) As a result of that liability or withdrawal, the institution's recalculated composite score is less than 1.0, as determined by the Secretary under [paragraph (e)](https://www.ecfr.gov/current/title-34/section-668.171#p-668.171(e)) of this section.

(2) For a publicly traded institution -

(i) The U.S. Securities and Exchange Commission (SEC) issues an order suspending or revoking the registration of the institution's securities pursuant to Section 12(j) of the Securities and Exchange Act of 1934 (the “Exchange Act”) or suspends trading of the institution's securities on any national securities exchange pursuant to Section 12(k) of the Exchange Act; or

(ii) The national securities exchange on which the institution's securities are traded notifies the institution that it is not in compliance with the exchange's listing requirements and, as a result, the institution's securities are delisted, either voluntarily or involuntarily, pursuant to the rules of the relevant national securities exchange.

(iii) The SEC is not in timely receipt of a required report and did not issue an extension to file the report.

(3) For the period described in [(c)(1)](https://www.ecfr.gov/current/title-34/section-668.171#p-668.171(c)(1)) of this section, when the institution is subject to two or more discretionary triggering events, as defined in [paragraph (d)](https://www.ecfr.gov/current/title-34/section-668.171#p-668.171(d)) of this section, those events become mandatory triggering events, unless a triggering event is resolved before any subsequent event(s) occurs.

(d) ***Discretionary triggering events.*** The Secretary may determine that an institution is not able to meet its financial or administrative obligations under [paragraph (b)(3)(iii)](https://www.ecfr.gov/current/title-34/section-668.171#p-668.171(b)(3)(iii)) of this section if any of the following events is likely to have a material adverse effect on the financial condition of the institution -

(1) The accrediting agency for the institution issued an order, such as a show cause order or similar action, that, if not satisfied, could result in the withdrawal, revocation or suspension of institutional accreditation for failing to meet one or more of the agency's standards;

(2)

(i) The institution violated a provision or requirement in a security or loan agreement with a creditor; and

(ii) As provided under the terms of that security or loan agreement, a monetary or nonmonetary default or delinquency event occurs, or other events occur, that trigger or enable the creditor to require or impose on the institution, an increase in collateral, a change in contractual obligations, an increase in interest rates or payments, or other sanctions, penalties, or fees;

(3) The institution's State licensing or authorizing agency notified the institution that it has violated a State licensing or authorizing agency requirement and that the agency intends to withdraw or terminate the institution's licensure or authorization if the institution does not take the steps necessary to come into compliance with that requirement;

(4) For its most recently completed fiscal year, a proprietary institution did not receive at least 10 percent of its revenue from sources other than title IV, HEA program funds, as provided under [§ 668.28(c)](https://www.ecfr.gov/current/title-34/section-668.28#p-668.28(c));

(5) As calculated by the Secretary, the institution has high annual dropout rates; or

(6) The institution's two most recent official cohort default rates are 30 percent or greater, as determined under [subpart N of this part](https://www.ecfr.gov/current/title-34/part-668/subpart-N), unless -

(i) The institution files a challenge, request for adjustment, or appeal under that subpart with respect to its rates for one or both of those fiscal years; and

(ii) That challenge, request, or appeal remains pending, results in reducing below 30 percent the official cohort default rate for either or both of those years, or precludes the rates from either or both years from resulting in a loss of eligibility or provisional certification.

(e) ***Recalculating the composite score.*** The Secretary recalculates an institution's most recent composite score by recognizing the actual amount of the liability, or cumulative liabilities, incurred by an institution under [paragraph (c)(1)(i)(A)](https://www.ecfr.gov/current/title-34/section-668.171#p-668.171(c)(1)(i)(A)) of this section as an expense or accounting for the actual withdrawal, or cumulative withdrawals, of owner's equity under [paragraph (c)(1)(i)(B)](https://www.ecfr.gov/current/title-34/section-668.171#p-668.171(c)(1)(i)(B)) of this section as a reduction in equity, and accounts for that expense or withdrawal by -

(1) For liabilities incurred by a proprietary institution -

(i) For the primary reserve ratio, increasing expenses and decreasing adjusted equity by that amount;

(ii) For the equity ratio, decreasing modified equity by that amount; and

(iii) For the net income ratio, decreasing income before taxes by that amount;

(2) For liabilities incurred by a non-profit institution -

(i) For the primary reserve ratio, increasing expenses and decreasing expendable net assets by that amount;

(ii) For the equity ratio, decreasing modified net assets by that amount; and

(iii) For the net income ratio, decreasing change in net assets without donor restrictions by that amount; and

(3) For the amount of owner's equity withdrawn from a proprietary institution -

(i) For the primary reserve ratio, decreasing adjusted equity by that amount; and

(ii) For the equity ratio, decreasing modified equity by that amount.

(f) ***Reporting requirements.***

(1) In accordance with procedures established by the Secretary, an institution must notify the Secretary of the following actions or events -

(i) For a liability incurred under [paragraph (c)(1)(i)(A)](https://www.ecfr.gov/current/title-34/section-668.171#p-668.171(c)(1)(i)(A)) of this section, no later than 10 days after the date of written notification to the institution of the final judgment or final determination;

(ii) For a withdrawal of owner's equity described in [paragraph (c)(1)(i)(B)](https://www.ecfr.gov/current/title-34/section-668.171#p-668.171(c)(1)(i)(B)) of this section -

(A) For a capital distribution that is the equivalent of wages in a sole proprietorship or partnership, no later than 10 days after the date the Secretary notifies the institution that its composite score is less than 1.5. In response to that notice, the institution must report the total amount of the wage-equivalent distributions it made during its prior fiscal year and any distributions that were made to pay any taxes related to the operation of the institution. During its current fiscal year and the first six months of its subsequent fiscal year (18-month period), the institution is not required to report any distributions to the Secretary, provided that the institution does not make wage-equivalent distributions that exceed 150 percent of the total amount of wage-equivalent distributions it made during its prior fiscal year, less any distributions that were made to pay any taxes related to the operation of the institution. However, if the institution makes wage-equivalent distributions that exceed 150 percent of the total amount of wage-equivalent distributions it made during its prior fiscal year less any distributions that were made to pay any taxes related to the operation of the institution at any time during the 18-month period, it must report each of those distributions no later than 10 days after they are made, and the Secretary recalculates the institution's composite score based on the cumulative amount of the distributions made at that time;

(B) For a distribution of dividends or return of capital, no later than 10 days after the dividends are declared or the amount of return of capital is approved; or

(C) For a related party receivable, not later than 10 days after that receivable occurs;

(iii) For the provisions relating to a publicly traded institution under [paragraph (c)(2)](https://www.ecfr.gov/current/title-34/section-668.171#p-668.171(c)(2)) of this section, no later than 10 days after the date that -

(A) The SEC issues an order suspending or revoking the registration of the institution's securities pursuant to Section 12(j) of the Exchange Act or suspends trading of the institution's securities on any national securities exchange pursuant to Section 12(k) of the Exchange Act; or

(B) The national securities exchange on which the institution's securities are traded involuntarily delists its securities, or the institution voluntarily delists its securities, pursuant to the rules of the relevant national securities exchange;

(iv) For an action under [paragraph (d)(1)](https://www.ecfr.gov/current/title-34/section-668.171#p-668.171(d)(1)) of this section, 10 days after the date on which the institution is notified by its accrediting agency of that action;

(v) For the loan agreement provisions in [paragraph (d)(2)](https://www.ecfr.gov/current/title-34/section-668.171#p-668.171(d)(2)) of this section, 10 days after a loan violation occurs, the creditor waives the violation, or the creditor imposes sanctions or penalties in exchange or as a result of granting the waiver;

(vi) For a State agency notice relating to terminating an institution's licensure or authorization under [paragraph (d)(3)](https://www.ecfr.gov/current/title-34/section-668.171#p-668.171(d)(3)) of this section, 10 days after the date on which the institution receives that notice; and

(vii) For the non-title IV revenue provision in [paragraph (d)(4)](https://www.ecfr.gov/current/title-34/section-668.171#p-668.171(d)(4)) of this section, no later than 45 days after the end of the institution's fiscal year, as provided in [§ 668.28(c)(3)](https://www.ecfr.gov/current/title-34/section-668.28#p-668.28(c)(3)).

(2) The Secretary may take an administrative action under [paragraph (i)](https://www.ecfr.gov/current/title-34/section-668.171#p-668.171(i)) of this section against an institution, or determine that the institution is not financially responsible, if it fails to provide timely notice to the Secretary as provided under [paragraph (f)(1)](https://www.ecfr.gov/current/title-34/section-668.171#p-668.171(f)(1)) of this section, or fails to respond, within the timeframe specified by the Secretary, to any determination made, or request for information, by the Secretary under [paragraph (f)(3)](https://www.ecfr.gov/current/title-34/section-668.171#p-668.171(f)(3)) of this section.

(3)

(i) In its notice to the Secretary under this paragraph, or in its response to a preliminary determination by the Secretary that the institution is not financially responsible because of a triggering event under [paragraph (c)](https://www.ecfr.gov/current/title-34/section-668.171#p-668.171(c)) or [(d)](https://www.ecfr.gov/current/title-34/section-668.171#p-668.171(d)) of this section, in accordance with procedures established by the Secretary, the institution may -

(A) Demonstrate that the reported withdrawal of owner's equity under [paragraph (c)(1)(i)(B)](https://www.ecfr.gov/current/title-34/section-668.171#p-668.171(c)(1)(i)(B)) of this section was used exclusively to meet tax liabilities of the institution or its owners for income derived from the institution;

(B) Show that the creditor waived a violation of a loan agreement under [paragraph (d)(2)](https://www.ecfr.gov/current/title-34/section-668.171#p-668.171(d)(2)) of this section. However, if the creditor imposes additional constraints or requirements as a condition of waiving the violation, or imposes penalties or requirements under [paragraph (d)(2)(ii)](https://www.ecfr.gov/current/title-34/section-668.171#p-668.171(d)(2)(ii)) of this section, the institution must identify and describe those penalties, constraints, or requirements and demonstrate that complying with those actions will not adversely affect the institution's ability to meet its financial obligations;

(C) Show that the triggering event has been resolved, or demonstrate that the institution has insurance that will cover all or part of the liabilities that arise under [paragraph (c)(1)(i)(A)](https://www.ecfr.gov/current/title-34/section-668.171#p-668.171(c)(1)(i)(A)) of this section; or

(D) Explain or provide information about the conditions or circumstances that precipitated a triggering event under [paragraph (c)](https://www.ecfr.gov/current/title-34/section-668.171#p-668.171(c)) or [(d)](https://www.ecfr.gov/current/title-34/section-668.171#p-668.171(d)) of this section that demonstrates that the triggering event has not or will not have a material adverse effect on the institution.

(ii) The Secretary will consider the information provided by the institution in determining whether to issue a final determination that the institution is not financially responsible.

(g) ***Public institutions.***

(1) The Secretary considers a domestic public institution to be financially responsible if the institution -

(i)

(A) Notifies the Secretary that it is designated as a public institution by the State, local, or municipal government entity, tribal authority, or other government entity that has the legal authority to make that designation; and

(B) Provides a letter from an official of that State or other government entity confirming that the institution is a public institution; and

(ii) Is not subject to a condition of past performance under [§ 668.174](https://www.ecfr.gov/current/title-34/section-668.174).

(2) The Secretary considers a foreign public institution to be financially responsible if the institution -

(i)

(A) Notifies the Secretary that it is designated as a public institution by the country or other government entity that has the legal authority to make that designation; and

(B) Provides documentation from an official of that country or other government entity confirming that the institution is a public institution and is backed by the full faith and credit of the country or other government entity; and

(ii) Is not subject to a condition of past performance under [§ 668.174](https://www.ecfr.gov/current/title-34/section-668.174).

(h) ***Audit opinions and disclosures.*** Even if an institution satisfies all of the general standards of financial responsibility under [paragraph (b)](https://www.ecfr.gov/current/title-34/section-668.171#p-668.171(b)) of this section, the Secretary does not consider the institution to be financially responsible if, in the institution's audited financial statements, the opinion expressed by the auditor was an adverse, qualified, or disclaimed opinion, or the financial statements contain a disclosure in the notes to the financial statements that there is substantial doubt about the institution's ability to continue as a going concern as required by accounting standards, unless the Secretary determines that a qualified or disclaimed opinion does not have a significant bearing on the institution's financial condition, or that the substantial doubt about the institution's ability to continue as going concern has been alleviated.

(i) ***Administrative actions.*** If the Secretary determines that an institution is not financially responsible under the standards and provisions of this section or under an alternative standard in [§ 668.175](https://www.ecfr.gov/current/title-34/section-668.175), or the institution does not submit its financial and compliance audits by the date and in the manner required under [§ 668.23](https://www.ecfr.gov/current/title-34/section-668.23), the Secretary may -

(1) Initiate an action under [subpart G of this part](https://www.ecfr.gov/current/title-34/part-668/subpart-G) to fine the institution, or limit, suspend, or terminate the institution's participation in the title IV, HEA programs;

(2) For an institution that is provisionally certified, take an action against the institution under the procedures established in [§ 668.13(d)](https://www.ecfr.gov/current/title-34/section-668.13#p-668.13(d)); or

(3) Deny the institution's application for certification or recertification to participate in the title IV, HEA programs.

[[84 FR 49911](https://www.federalregister.gov/citation/84-FR-49911), Sept. 23, 2019, as amended at [85 FR 54818](https://www.federalregister.gov/citation/85-FR-54818), Sept. 2, 2020]

**§ 668.172 Financial ratios.**

(a) ***Appendices A and B, ratio methodology.*** As provided under appendices A and B to this subpart, the Secretary determines an institution's composite score by -

(1) Calculating the result of its Primary Reserve, Equity, and Net Income ratios, as described under [paragraph (b)](https://www.ecfr.gov/current/title-34/section-668.172#p-668.172(b)) of this section;

(2) Calculating the strength factor score for each of those ratios by using the corresponding algorithm;

(3) Calculating the weighted score for each ratio by multiplying the strength factor score by its corresponding weighting percentage;

(4) Summing the resulting weighted scores to arrive at the composite score; and

(5) Rounding the composite score to one digit after the decimal point.

(b) ***Ratios.*** The Primary Reserve, Equity, and Net Income ratios are defined under appendix A for proprietary institutions, and under appendix B for private non-profit institutions.

(1) The ratios for proprietary institutions are:

For proprietary institutions:



(2) The ratios for private non-profit institutions are:



(c) ***Excluded items.*** In calculating an institution's ratios, the Secretary -

(1) Generally excludes extraordinary gains or losses, income or losses from discontinued operations, prior period adjustments, the cumulative effect of changes in accounting principles, and the effect of changes in accounting estimates;

(2) May include or exclude the effects of questionable accounting treatments, such as excessive capitalization of marketing costs;

(3) Excludes all unsecured or uncollateralized related-party receivables;

(4) Excludes all intangible assets defined as intangible in accordance with generally accepted accounting principles; and

(5) Excludes from the ratio calculations Federal funds provided to an institution by the Secretary under program authorized by the HEA only if -

(i) In the notes to the institution's audited financial statement, or as a separate attestation, the auditor discloses by name and CFDA number, the amount of HEA program funds reported as expenses in the Statement of Activities for the fiscal year covered by that audit or attestation; and

(ii) The institution's composite score, as determined by the Secretary, is less than 1.5 before the reported expenses arising from those HEA funds are excluded from the ratio calculations.

(d) ***Accounting for operating leases.*** The Secretary accounts for operating leases by -

(1) Applying FASB Accounting Standards Update (ASU) 2016-02, Leases (Topic 842) to all leases the institution has entered into on or after December 15, 2018 (post-implementation operating/financing leases), as specified in the Supplemental Schedule (see Section 2 of Appendix A to this subpart and Section 2 of Appendix B to this subpart);

(2) Treating leases the institution entered into prior to December 15, 2018 (pre-implementation operating/financing leases), as they would have been treated prior to the requirements of ASU 2016-02, as long as the institution provides information about those leases on the Supplemental Schedule and a note in, or on the face of, its audited financial statements; and

(3) Accounting for any adjustments, such as any options exercised by the institution to extend the life of a pre-implementation operating/finance lease, as post-implementation operating/finance leases.

(e) ***Incorporation by Reference.***

(1) The material required in this section is incorporated by reference into this section with the approval of the Director of the Federal Register under [5 U.S.C. 552(a)](https://www.govinfo.gov/link/uscode/5/552) and [1 CFR part 51](https://www.ecfr.gov/current/title-1/part-51). All approved material is available for inspection at U.S. Department of Education, Office of the General Counsel, 202-401-6000, and is available from the sources indicated below. It is also available for inspection at the National Archives and Records Administration (NARA). For information on the availability of this material at NARA, email *fedreg.legal@nara.gov* or go to [*www.archives.gov/federal-register/cfr/ibr-locations.html*](http://www.archives.gov/federal-register/cfr/ibr-locations.html)*.*

(2) Financial Accounting Standards Board (FASB), 401 Merritt 7, P.O. Box 5116, Norwalk, CT 06856-5116, (203) 847-0700, [*www.fasb.org*](http://www.fasb.org)*.*

(i) Accounting Standards Update (ASU) 2016-02, Leases (Topic 842), (February 2016).

(ii) [Reserved]

(Approved by the Office of Management and Budget under control number 1840-0537)

[[62 FR 62877](https://www.federalregister.gov/citation/62-FR-62877), Nov. 25, 1997, as amended at [63 FR 40348](https://www.federalregister.gov/citation/63-FR-40348), July 28, 1998; [65 FR 65637](https://www.federalregister.gov/citation/65-FR-65637), Nov. 1, 2000; [84 FR 49913](https://www.federalregister.gov/citation/84-FR-49913), Sept. 23, 2019]

**§ 668.173 Refund reserve standards.**

(a) ***General.*** The Secretary considers that an institution has sufficient cash reserves, as required under [§ 668.171(b)(2)](https://www.ecfr.gov/current/title-34/section-668.171#p-668.171(b)(2)), if the institution -

(1) Satisfies the requirements for a public institution under [§ 668.171(c)(1)](https://www.ecfr.gov/current/title-34/section-668.171#p-668.171(c)(1));

(2) Is located in a State that has a tuition recovery fund approved by the Secretary and the institution contributes to that fund; or

(3) Returns, in a timely manner as described in [paragraph (b)](https://www.ecfr.gov/current/title-34/section-668.173#p-668.173(b)) of this section, unearned title IV, HEA program funds that it is responsible for returning under the provisions of [§ 668.22](https://www.ecfr.gov/current/title-34/section-668.22) for a student that withdrew from the institution.

(b) ***Timely return of title IV, HEA program funds.*** In accordance with procedures established by the Secretary or FFEL Program lender, an institution returns unearned title IV, HEA program funds timely if -

(1) The institution deposits or transfers the funds into the bank account it maintains under [§ 668.163](https://www.ecfr.gov/current/title-34/section-668.163) no later than 45 days after the date it determines that the student withdrew;

(2) The institution initiates an electronic funds transfer (EFT) no later than 45 days after the date it determines that the student withdrew;

(3) The institution initiates an electronic transaction, no later than 45 days after the date it determines that the student withdrew, that informs a FFEL lender to adjust the borrower's loan account for the amount returned; or

(4) The institution issues a check no later than 45 days after the date it determines that the student withdrew. An institution does not satisfy this requirement if -

(i) The institution's records show that the check was issued more than 45 days after the date the institution determined that the student withdrew; or

(ii) The date on the cancelled check shows that the bank used by the Secretary or FFEL Program lender endorsed that check more than 60 days after the date the institution determined that the student withdrew.

(c) ***Compliance thresholds.***

(1) An institution does not comply with the reserve standard under [§ 668.173(a)(3)](https://www.ecfr.gov/current/title-34/section-668.173#p-668.173(a)(3)) if, in a compliance audit conducted under [§ 668.23](https://www.ecfr.gov/current/title-34/section-668.23), an audit conducted by the Office of the Inspector General, or a program review conducted by the Department or guaranty agency, the auditor or reviewer finds -

(i) In the sample of student records audited or reviewed that the institution did not return unearned title IV, HEA program funds within the timeframes described in [paragraph (b)](https://www.ecfr.gov/current/title-34/section-668.173#p-668.173(b)) of this section for 5% or more of the students in the sample. (For purposes of determining this percentage, the sample includes only students for whom the institution was required to return unearned funds during its most recently completed fiscal year.); or

(ii) A material weakness or reportable condition in the institution's report on internal controls relating to the return of unearned title IV, HEA program funds.

(2) The Secretary does not consider an institution to be out of compliance with the reserve standard under [§ 668.173(a)(3)](https://www.ecfr.gov/current/title-34/section-668.173#p-668.173(a)(3)) if the institution is cited in any audit or review report because it did not return unearned funds in a timely manner for one or two students, or for less than 5% of the students in the sample referred to in [paragraph (c)(1)(i)](https://www.ecfr.gov/current/title-34/section-668.173#p-668.173(c)(1)(i)) of this section.

(d) ***Letter of credit.***

(1) Except as provided under [paragraph (e)(1)](https://www.ecfr.gov/current/title-34/section-668.173#p-668.173(e)(1)) of this section, an institution that can satisfy the reserve standard only under [paragraph (a)(3)](https://www.ecfr.gov/current/title-34/section-668.173#p-668.173(a)(3)) of this section, must submit an irrevocable letter of credit acceptable and payable to the Secretary if a finding in an audit or review shows that the institution exceeded the compliance thresholds in [paragraph (c)](https://www.ecfr.gov/current/title-34/section-668.173#p-668.173(c)) of this section for either of its two most recently completed fiscal years.

(2) The amount of the letter of credit required under [paragraph (d)(1)](https://www.ecfr.gov/current/title-34/section-668.173#p-668.173(d)(1)) of this section is 25 percent of the total amount of unearned title IV, HEA program funds that the institution was required to return under [§ 668.22](https://www.ecfr.gov/current/title-34/section-668.22) during the institution's most recently completed fiscal year.

(3) An institution that is subject to [paragraph (d)(1)](https://www.ecfr.gov/current/title-34/section-668.173#p-668.173(d)(1)) of this section must submit to the Secretary a letter of credit no later than 30 days after the earlier of the date that -

(i) The institution is required to submit its compliance audit;

(ii) The Office of the Inspector General issues a final audit report;

(iii) The designated department official issues a final program review determination;

(iv) The Department issues a preliminary program review report or draft audit report, or a guaranty agency issues a preliminary report showing that the institution did not return unearned funds for more than 10% of the sampled students; or

(v) The Secretary sends a written notice to the institution requesting the letter of credit that explains why the institution has failed to return unearned funds in a timely manner.

(e) ***Exceptions.*** With regard to the letter of credit described in [paragraph (d)](https://www.ecfr.gov/current/title-34/section-668.173#p-668.173(d)) of this section -

(1) An institution does not have to submit the letter of credit if the amount calculated under [paragraph (d)(2)](https://www.ecfr.gov/current/title-34/section-668.173#p-668.173(d)(2)) of this section is less than $5,000 and the institution can demonstrate that it has cash reserves of at least $5,000 available at all times.

(2) An institution may delay submitting the letter of credit and request the Secretary to reconsider a finding made in its most recent audit or review report that it failed to return unearned title IV, HEA program funds in a timely manner if -

(i)

(A) The institution submits documents showing that the unearned title IV, HEA program funds were not returned in a timely manner solely because of exceptional circumstances beyond the institution's control and that the institution would not have exceeded the compliance thresholds under [paragraph (c)(1)](https://www.ecfr.gov/current/title-34/section-668.173#p-668.173(c)(1)) of this section had it not been for these exceptional circumstances; or

(B) The institution submits documents showing that it did not fail to make timely refunds as provided under [paragraphs (b)](https://www.ecfr.gov/current/title-34/section-668.173#p-668.173(b)) and [(c)](https://www.ecfr.gov/current/title-34/section-668.173#p-668.173(c)) of this section; and

(ii) The institution's request, along with the documents described in [paragraph (e)(2)(i)](https://www.ecfr.gov/current/title-34/section-668.173#p-668.173(e)(2)(i)) of this section, is submitted to the Secretary no later than the date it would otherwise be required to submit a letter of credit under paragraph (d)(3).

(3) If the Secretary denies the institution's request under [paragraph (e)(2)](https://www.ecfr.gov/current/title-34/section-668.173#p-668.173(e)(2)) of this section, the Secretary notifies the institution of the date it must submit the letter of credit.

(f) ***State tuition recovery funds.*** In determining whether to approve a State's tuition recovery fund, the Secretary considers the extent to which that fund -

(1) Provides refunds to both in-State and out-of-State students;

(2) Allocates all refunds in accordance with the order required under [§ 668.22](https://www.ecfr.gov/current/title-34/section-668.22); and

(3) Provides a reliable mechanism for the State to replenish the fund should any claims arise that deplete the fund's assets.

(Authority: [20 U.S.C. 1094](https://www.govinfo.gov/link/uscode/20/1094) and [1099c](https://www.govinfo.gov/link/uscode/20/1099c) and section 4 of Pub. L. 95-452, 92 Stat. 1101-1109)

(Approved by the Office of Management and Budget under control number 1845-0022)

[[62 FR 62877](https://www.federalregister.gov/citation/62-FR-62877), Nov. 25, 1997, as amended at [63 FR 40348](https://www.federalregister.gov/citation/63-FR-40348), July 28, 1998; [64 FR 59042](https://www.federalregister.gov/citation/64-FR-59042), Nov. 1, 1999; [67 FR 67074](https://www.federalregister.gov/citation/67-FR-67074), Nov. 1, 2003; [71 FR 45696](https://www.federalregister.gov/citation/71-FR-45696), Aug. 9, 2006]

**§ 668.174 Past performance.**

(a) ***Past performance of an institution.*** An institution is not financially responsible if the institution -

(1) Has been limited, suspended, terminated, or entered into a settlement agreement to resolve a limitation, suspension, or termination action initiated by the Secretary or a guaranty agency, as defined in [34 CFR part 682](https://www.ecfr.gov/current/title-34/part-682), within the preceding five years;

(2) In either of its two most recent compliance audits had an audit finding, or in a report issued by the Secretary had a program review finding for its current fiscal year or either of its preceding two fiscal years, that resulted in the institution's being required to repay an amount greater than 5 percent of the funds that the institution received under the title IV, HEA programs during the year covered by that audit or program review;

(3) Has been cited during the preceding five years for failure to submit in a timely fashion acceptable compliance and financial statement audits required under this part, or acceptable audit reports required under the individual title IV, HEA program regulations; or

(4) Has failed to resolve satisfactorily any compliance problems identified in audit or program review reports based upon a final decision of the Secretary issued pursuant to [subpart G](https://www.ecfr.gov/current/title-34/part-668/subpart-G) or [H of this part](https://www.ecfr.gov/current/title-34/part-668/subpart-H).

(b) ***Past performance of persons or entities affiliated with an institution.***

(1)

(i) Except as provided in [paragraph (b)(2)](https://www.ecfr.gov/current/title-34/section-668.174#p-668.174(b)(2)) of this section, an institution is not financially responsible if a person or entity who exercises substantial ownership or control over the institution, as described under [34 CFR 600.31](https://www.ecfr.gov/current/title-34/section-600.31), or any member or members of that person's family alone or together -

(A) Exercises or exercised substantial ownership or control over another institution or a third-party servicer that owes a liability for a violation of a title IV, HEA program requirement;

(B) Exercised substantial ownership or control over another institution that closed without a viable teach-out plan or agreement approved by the institution's accrediting agency and faithfully executed by the institution; or

(C) Owes a liability for a violation of a title IV, HEA program requirement; and

(ii) That person, entity, family member, institution, or servicer does not demonstrate that the liability is being repaid in accordance with an agreement with the Secretary.

(2) The Secretary may determine that an institution is financially responsible, even if the institution is not otherwise financially responsible under [paragraph (b)(1)](https://www.ecfr.gov/current/title-34/section-668.174#p-668.174(b)(1)) of this section, if -

(i) The institution notifies the Secretary, within the time permitted and in the manner provided under [34 CFR 600.30](https://www.ecfr.gov/current/title-34/section-600.30), that the person or entity referenced in [paragraph (b)(1)](https://www.ecfr.gov/current/title-34/section-668.174#p-668.174(b)(1)) of this section exercises substantial control over the institution; and

(ii) The person or entity referenced in [paragraph (b)(1)](https://www.ecfr.gov/current/title-34/section-668.174#p-668.174(b)(1)) of this section repaid to the Secretary a portion of the applicable liability, and the portion repaid equals or exceeds the greater of -

(A) The total percentage of the ownership interest held in the institution or third-party servicer that owes the liability by that entity, person or any member or members of that person's family, either alone or in combination with one another;

(B) The total percentage of the ownership interest held in the institution or servicer that owes the liability that the entity, person or any member or members of the person's family, either alone or in combination with one another, represents or represented under a voting trust, power of attorney, proxy, or similar agreement; or

(C) Twenty-five percent, if the person or any member of the person's family is or was a member of the board of directors, chief executive officer, or other executive officer of the institution or servicer that owes the liability, or of an entity holding at least a 25 percent ownership interest in the institution that owes the liability; or

(iii) The applicable liability described in [paragraph (b)(1)](https://www.ecfr.gov/current/title-34/section-668.174#p-668.174(b)(1)) of this section is currently being repaid in accordance with a written agreement with the Secretary; or

(iv) The institution demonstrates to the satisfaction of the Secretary why -

(A) The person or entity who exercises substantial control over the institution should nevertheless be considered to lack that control; or

(B) The person or entity who exercises substantial control over the institution and each member of that person's family nevertheless does not or did not exercise substantial control over the institution or servicer that owes the liability.

(c) ***Ownership interest.***

(1) An ownership interest is a share of the legal or beneficial ownership or control of, or a right to share in the proceeds of the operation of, an institution, an institution's parent corporation, a third-party servicer, or a third-party servicer's parent corporation. The term “ownership interest” includes, but is not limited to -

(i) An interest as tenant in common, joint tenant, or tenant by the entireties;

(ii) A partnership; and

(iii) An interest in a trust.

(2) The term “ownership interest” does not include any share of the ownership or control of, or any right to share in the proceeds of the operation of a profit-sharing plan, provided that all employees are covered by the plan.

(3) The Secretary generally considers a person or entity to exercise substantial control over an institution or third-party servicer if the person or entity -

(i) Directly or indirectly holds at least a 25 percent ownership interest in the institution or servicer;

(ii) Holds, together with other members of his or her family, at least a 25 percent ownership interest in the institution or servicer;

(iii) Represents, either alone or together with other persons under a voting trust, power of attorney, proxy, or similar agreement, one or more persons who hold, either individually or in combination with the other persons represented or the person representing them, at least a 25 percent ownership in the institution or servicer; or

(iv) Is a member of the board of directors, a general partner, the chief executive officer, or other executive officer of -

(A) The institution or servicer; or

(B) An entity that holds at least a 25 percent ownership interest in the institution or servicer.

(4) “Family member” is defined in [§ 600.21(f) of this chapter](https://www.ecfr.gov/current/title-34/section-600.21#p-600.21(f)).

(Approved by the Office of Management and Budget under control number 1840-0537)

[[62 FR 62877](https://www.federalregister.gov/citation/62-FR-62877), Nov. 25, 1997, as amended at [63 FR 40348](https://www.federalregister.gov/citation/63-FR-40348), [40349](https://www.federalregister.gov/citation/63-FR-40349), July 28, 1998; [67 FR 67075](https://www.federalregister.gov/citation/67-FR-67075), Nov. 1, 2002; [85 FR 54818](https://www.federalregister.gov/citation/85-FR-54818), Sept. 2, 2020]

**§ 668.175 Alternative standards and requirements.**

(a) ***General.*** An institution that is not financially responsible under the general standards and provisions in [§ 668.171](https://www.ecfr.gov/current/title-34/section-668.171), may begin or continue to participate in the title IV, HEA programs by qualifying under an alternate standard set forth in this section.

(b) ***Letter of Credit or surety alternative for new institutions.*** A new institution that is not financially responsible solely because the Secretary determines that its composite score is less than 1.5, qualifies as a financially responsible institution by submitting an irrevocable letter of credit that is acceptable and payable to the Secretary, or providing other surety described under [paragraph (h)(2)(i)](https://www.ecfr.gov/current/title-34/section-668.175#p-668.175(h)(2)(i)) of this section, for an amount equal to at least one-half of the amount of title IV, HEA program funds that the Secretary determines the institution will receive during its initial year of participation. A new institution is an institution that seeks to participate for the first time in the title IV, HEA programs.

(c) ***Financial protection alternative for participating institutions.*** A participating institution that is not financially responsible either because it does not satisfy one or more of the standards of financial responsibility under [§ 668.171(b)](https://www.ecfr.gov/current/title-34/section-668.171#p-668.171(b)), [(c)](https://www.ecfr.gov/current/title-34/section-668.171#p-668.171(c)), or [(d)](https://www.ecfr.gov/current/title-34/section-668.171#p-668.171(d)), or because of an audit opinion or going concern disclosure described under [§ 668.171(h)](https://www.ecfr.gov/current/title-34/section-668.171#p-668.171(h)), qualifies as a financially responsible institution by submitting an irrevocable letter of credit that is acceptable and payable to the Secretary, or providing other financial protection described under [paragraph (h)](https://www.ecfr.gov/current/title-34/section-668.175#p-668.175(h)) of this section, for an amount determined by the Secretary that is not less than one-half of the title IV, HEA program funds received by the institution during its most recently completed fiscal year, except that this requirement does not apply to a public institution.

(d) ***Zone alternative.***

(1) A participating institution that is not financially responsible solely because the Secretary determines that its composite score under [§ 668.172](https://www.ecfr.gov/current/title-34/section-668.172) is less than 1.5 may participate in the title IV, HEA programs as a financially responsible institution for no more than three consecutive years, beginning with the year in which the Secretary determines that the institution qualifies under this alternative.

(i)

(A) An institution qualifies initially under this alternative if, based on the institution's audited financial statement for its most recently completed fiscal year, the Secretary determines that its composite score is in the range from 1.0 to 1.4; and

(B) An institution continues to qualify under this alternative if, based on the institution's audited financial statement for each of its subsequent two fiscal years, the Secretary determines that the institution's composite score is in the range from 1.0 to 1.4.

(ii) An institution that qualified under this alternative for three consecutive years, or for one of those years, may not seek to qualify again under this alternative until the year after the institution achieves a composite score of at least 1.5, as determined by the Secretary.

(2) Under the zone alternative, the Secretary -

(i) Requires the institution to make disbursements to eligible students and parents, and to otherwise comply with the provisions, under either the heightened cash monitoring or reimbursement payment method described in [§ 668.162](https://www.ecfr.gov/current/title-34/section-668.162);

(ii) Requires the institution to provide timely information regarding any of the following oversight and financial events -

(A) Any event that causes the institution, or related entity as defined in Accounting Standards Codification (ASC) 850, to realize any liability that was noted as a contingent liability in the institution's or related entity's most recent audited financial statement; or

(B) Any losses that are unusual in nature or infrequently occur, or both, as defined in accordance with Accounting Standards Update (ASU) No. 2015-01 and ASC 225;

(iii) May require the institution to submit its financial statement and compliance audits earlier than the time specified under [§ 668.23(a)(4)](https://www.ecfr.gov/current/title-34/section-668.23#p-668.23(a)(4)); and

(iv) May require the institution to provide information about its current operations and future plans.

(3) Under the zone alternative, the institution must -

(i) For any oversight or financial event described in [paragraph (d)(2)(ii)](https://www.ecfr.gov/current/title-34/section-668.175#p-668.175(d)(2)(ii)) of this section for which the institution is required to provide information, in accordance with procedures established by the Secretary, notify the Secretary no later than 10 days after that event occurs; and

(ii) As part of its compliance audit, require its auditor to express an opinion on the institution's compliance with the requirements under the zone alternative, including the institution's administration of the payment method under which the institution received and disbursed title IV, HEA program funds.

(4) If an institution fails to comply with the requirements under [paragraph (d)(2)](https://www.ecfr.gov/current/title-34/section-668.175#p-668.175(d)(2)) or [(3)](https://www.ecfr.gov/current/title-34/section-668.175#p-668.175(d)(3)) of this section, the Secretary may determine that the institution no longer qualifies under this alternative.

(e) [Reserved]

(f) ***Provisional certification alternative.***

(1) The Secretary may permit an institution that is not financially responsible to participate in the title IV, HEA programs under a provisional certification for no more than three consecutive years if -

(i) The institution is not financially responsible because it does not satisfy the general standards under [§ 668.171(b)](https://www.ecfr.gov/current/title-34/section-668.171#p-668.171(b)), its recalculated composite score under [§ 668.171(e)](https://www.ecfr.gov/current/title-34/section-668.171#p-668.171(e)) is less than 1.0, it is subject to an action or event under [§ 668.171(c)](https://www.ecfr.gov/current/title-34/section-668.171#p-668.171(c)), or an action or event under paragraph (d) that has an adverse material effect on the institution as determined by the Secretary, or because of an audit opinion or going concern disclosure described in [§ 668.171(h)](https://www.ecfr.gov/current/title-34/section-668.171#p-668.171(h)); or

(ii) The institution is not financially responsible because of a condition of past performance, as provided under [§ 668.174(a)](https://www.ecfr.gov/current/title-34/section-668.174#p-668.174(a)), and the institution demonstrates to the Secretary that it has satisfied or resolved that condition; and

(2) Under this alternative, the institution must -

(i) Provide to the Secretary an irrevocable letter of credit that is acceptable and payable to the Secretary, or provide other financial protection described under [paragraph (h)](https://www.ecfr.gov/current/title-34/section-668.175#p-668.175(h)) of this section, for an amount determined by the Secretary that is not less than 10 percent of the title IV, HEA program funds received by the institution during its most recently completed fiscal year, except that this requirement does not apply to a public institution that the Secretary determines is backed by the full faith and credit of the State;

(ii) Demonstrate that it was current on its debt payments and has met all of its financial obligations, as required under [§ 668.171(b)(3)](https://www.ecfr.gov/current/title-34/section-668.171#p-668.171(b)(3)), for its two most recent fiscal years; and

(iii) Comply with the provisions under the zone alternative, as provided under [paragraph (d)(2)](https://www.ecfr.gov/current/title-34/section-668.175#p-668.175(d)(2)) and [(3)](https://www.ecfr.gov/current/title-34/section-668.175#p-668.175(d)(3)) of this section.

(3) If at the end of the period for which the Secretary provisionally certified the institution, the institution is still not financially responsible, the Secretary may again permit the institution to participate under a provisional certification but the Secretary -

(i) May require the institution, or one or more persons or entities that exercise substantial control over the institution, as determined under [§ 668.174(b)(1)](https://www.ecfr.gov/current/title-34/section-668.174#p-668.174(b)(1)) and [(c)](https://www.ecfr.gov/current/title-34/section-668.174#p-668.174(c)), or both, to provide to the Secretary financial guarantees for an amount determined by the Secretary to be sufficient to satisfy any potential liabilities that may arise from the institution's participation in the title IV, HEA programs;

(ii) May require one or more of the persons or entities that exercise substantial control over the institution, as determined under [§ 668.174(b)(1)](https://www.ecfr.gov/current/title-34/section-668.174#p-668.174(b)(1)) and [(c)](https://www.ecfr.gov/current/title-34/section-668.174#p-668.174(c)), to be jointly or severally liable for any liabilities that may arise from the institution's participation in the title IV, HEA programs; and

(iii) May require the institution to provide, or continue to provide, the financial protection resulting from an event described in [§ 668.171(c)](https://www.ecfr.gov/current/title-34/section-668.171#p-668.171(c)) and [(d)](https://www.ecfr.gov/current/title-34/section-668.171#p-668.171(d)) until the institution meets the requirements of [paragraph (f)(4)](https://www.ecfr.gov/current/title-34/section-668.175#p-668.175(f)(4)) of this section.

(4) The Secretary maintains the full amount of financial protection provided by the institution under this section until the Secretary first determines that the institution has -

(i) A composite score of 1.0 or greater based on a review of the audited financial statements for the fiscal year in which all liabilities from any event described in [§ 668.171(c)](https://www.ecfr.gov/current/title-34/section-668.171#p-668.171(c)) or [(d)](https://www.ecfr.gov/current/title-34/section-668.171#p-668.171(d)) on which financial protection was required; or

(ii) A recalculated composite score of 1.0 or greater, and any event or condition described in [§ 668.171(c)](https://www.ecfr.gov/current/title-34/section-668.171#p-668.171(c)) or [(d)](https://www.ecfr.gov/current/title-34/section-668.171#p-668.171(d)) has ceased to exist.

(g) ***Provisional certification alternative for persons or entities owing liabilities.***

(1) The Secretary may permit an institution that is not financially responsible because the persons or entities that exercise substantial control over the institution owe a liability for a violation of a title IV, HEA program requirement, to participate in the title IV, HEA programs under a provisional certification only if -

(i)

(A) The persons or entities that exercise substantial control, as determined under [§ 668.174(b)(1)](https://www.ecfr.gov/current/title-34/section-668.174#p-668.174(b)(1)) and [(c)](https://www.ecfr.gov/current/title-34/section-668.174#p-668.174(c)), repay or enter into an agreement with the Secretary to repay the applicable portion of that liability, as provided under [§ 668.174(b)(2)(ii)](https://www.ecfr.gov/current/title-34/section-668.174#p-668.174(b)(2)(ii)); or

(B) The institution assumes that liability, and repays or enters into an agreement with the Secretary to repay that liability;

(ii) The institution satisfies the general standards and provisions of financial responsibility under [§ 668.171(b)](https://www.ecfr.gov/current/title-34/section-668.171#p-668.171(b)) and [(d)(1)](https://www.ecfr.gov/current/title-34/section-668.171#p-668.171(d)(1)), except that institution must demonstrate that it was current on its debt payments and has met all of its financial obligations, as required under [§ 668.171 (b)(3)](https://www.ecfr.gov/current/title-34/section-668.171#p-668.171(b)(3)) and [(b)(4)](https://www.ecfr.gov/current/title-34/section-668.171#p-668.171(b)(4)), for its two most recent fiscal years; and

(iii) The institution submits to the Secretary an irrevocable letter of credit that is acceptable and payable to the Secretary, for an amount determined by the Secretary that is not less than 10 percent of the title IV, HEA program funds received by the institution during its most recently completed fiscal year.

(2) Under this alternative, the Secretary -

(i) Requires the institution to comply with the provisions under the zone alternative, as provided under [paragraph (d) (2)](https://www.ecfr.gov/current/title-34/section-668.175#p-668.175(d)(2)) and [(3)](https://www.ecfr.gov/current/title-34/section-668.175#p-668.175(d)(3)) of this section;

(ii) May require the institution, or one or more persons or entities that exercise substantial control over the institution, or both, to submit to the Secretary financial guarantees for an amount determined by the Secretary to be sufficient to satisfy any potential liabilities that may arise from the institution's participation in the title IV, HEA programs; and

(iii) May require one or more of the persons or entities that exercise substantial control over the institution to be jointly or severally liable for any liabilities that may arise from the institution's participation in the title IV, HEA programs.

(h) ***Financial protection.***

(1) In accordance with procedures established by the Secretary or as part of an agreement with an institution under this section, the Secretary may use the funds from that financial protection to satisfy the debts, liabilities, or reimbursable costs, including costs associated with teach-outs as allowed by the Department, owed to the Secretary that are not otherwise paid directly by the institution.

(2) In lieu of submitting a letter of credit for the amount required by the Secretary under this section, the Secretary may permit an institution to -

(i) Provide the amount required in the form of other surety or financial protection that the Secretary specifies in a document published in the Federal Register;

(ii) Provide cash for the amount required; or

(iii) Enter into an arrangement under which the Secretary offsets the amount of title IV, HEA program funds that an institution has earned in a manner that ensures that, no later than the end of a six to twelve-month period selected by the Secretary, the amount offset equals the amount of financial protection the institution is required to provide. The Secretary provides to the institution any funds not used for the purposes described in [paragraph (h)(1)](https://www.ecfr.gov/current/title-34/section-668.175#p-668.175(h)(1)) of this section during the period covered by the agreement, or provides the institution any remaining funds if the institution subsequently submits other financial protection for the amount originally required.

[[62 FR 62877](https://www.federalregister.gov/citation/62-FR-62877), Nov. 25, 1997, as amended at [63 FR 40348](https://www.federalregister.gov/citation/63-FR-40348), [40349](https://www.federalregister.gov/citation/63-FR-40349), July 28, 1998; [81 FR 76075](https://www.federalregister.gov/citation/81-FR-76075), Nov. 1, 2016; [84 FR 49913](https://www.federalregister.gov/citation/84-FR-49913), Sept. 23, 2019]

**§ 668.176 Severability.**

If any provision of this subpart or its application to any person, act, or practice is held invalid, the remainder of the subpart or the application of its provisions to any person, act, or practice will not be affected thereby.