

ED Proposes Significant Amendments to Change in Control and 90/10 Regulations

August 23, 2022

COMMENTS DUE THIS WEEK

On July 28, 2022, the US Department of Education (ED) published a [Notice of Proposed Rulemaking](#) (NPRM) to amend its 90/10 and change of ownership and control regulations.

ED is accepting comments on the rule package until **August 26, 2022**, before it issues a final rule. We expect ED will publish the rule package in final form no later than November 1, which allows the rules to take effect next July 1, 2023, under ED's master calendar requirements. If ED misses the November 1 deadline, the final rule would likely take effect July 1, 2024.

Negotiated Rulemaking (Neg Reg) History

The change in control and 90/10 proposals are part of ED's 2022 negotiated rulemaking process, which wrapped up a series of hearings earlier this year. ED's Neg Reg committee, which consisted of stakeholders and experts in the covered issues, discussed rule proposals across seven broad federal student aid topics. Although ED was expected to issue NPRMs on each of the topics this summer, ED indicated in June it would delay most of the proposals until 2023. The change in ownership/control and 90/10 changes issued in this NPRM are now the only remaining proposals from the federal student aid topics expected this year. Although this proposal has gotten less attention than those related to borrower defense to repayment issues earlier this year, some of these changes are equally as important and will materially modify existing regulatory standards.

Neg Reg committees usually consist of stakeholders with wide-ranging perspectives, including representatives from regulatory agencies, students, consumer advocacy groups and ED itself. Given the range of views, consensus is rare. In the 2022 sessions, the committee only reached consensus on two of the seven topics: 90/10 and ability-to-benefit proposals. The 90/10 proposal in this NPRM, therefore, reflects the committee's consensus language and therefore is the least likely to change regardless of comment. However, because of the potentially significant implications, we encourage impacted institutions to provide feedback. The committee did not reach consensus on the change in ownership and control proposal, so the NPRM language is ED's own proposal, although it is similar to proposals that were discussed in the public hearing.

90/10

The 90/10 proposal updates the treatment of federal funds in the calculation and makes other modifications to the sources of funding that can be included as revenue. Under the existing 90/10 rule, proprietary institutions must derive at least 10% of their revenue from sources other than federal funding in order to maintain eligibility for the federal student aid programs. Currently, the federal funding includes only Title IV funding on the "90 side" of the calculation, while all other federal funding (such as veterans funding) is counted on the "10 side" of the equation (Ten Money).

However, in March 2021, the President signed [the American Rescue Plan Act of 2021](#) (ARPA), which [specified that all federal funding will count on the 90 side](#) beginning with fiscal years starting on or after January 1, 2023.

ED's NPRM implements the ARPA by expanding the scope of funds that count toward the 90 side to include all federal funds that are disbursed or delivered to or on behalf of a student to attend an institution, including both veteran and active service military benefits. In practice, this means that sources of federal funding that tend to be significant sources of Ten Money (such as funding from the Post 9/11 GI Bill) are no longer Ten Money and are instead on the 90 side.

The NPRM also proposes several other changes to the 90/10 regulations that will significantly impact the calculation and alternative sources of "Ten Money." Like the statutory change, the regulation changes would apply to fiscal years beginning on or after January 1, 2023.

The following are the key proposals:

- **Federal funds on the 90 side:** The NPRM updates the regulatory language to state that all federal funding paid either to the institution or the student to cover tuition, fees, or other institutional charges counts on the 90 side of the calculation. This proposal is based on a specific statutory change in ARPA, and ED's revision is just to implement that change. The NPRM adds a related proposal to clarify the impact of this change: ED will publish in the *Federal Register* a list of federal sources that must be counted on the 90 side and make periodic updates to the list as needed. The main goal of the list is to identify sources of federal funding that may get paid directly to students without the institution's knowledge, but are still intended to cover tuition, fees, or institutional charges and are therefore must be included in the calculation. Unfortunately, the timing of this publication is unclear and could define revenue categories during the fiscal year in question, making rate management challenging.
- **Clarify treatment of revenue from services performed by students:** To count revenue generated by activities conducted by the institution for training and education, the revenue must be directly related to services performed by students. For example, a cosmetology program could count funds generated from hair-styling services provided by a student but not the sale of beauty products to customers receiving services. ED explained that this change is intended ensure that institutions are not including revenue from tangential activities that are indirectly related to services provided by students.
- **Restrictions on revenue from ineligible programs:** The rule also creates restrictions on counting revenue generated from programs that are ineligible for Title IV and significantly revising amounts previously eligible for inclusion in the 90/10 rate since 2008. Institutions can count revenue from ineligible programs as non-federal revenue only if (1) the funds paid on behalf of a student are not from a source related to the institution or its owners or affiliates; (2) the program does not include courses offered in the institution's eligible programs; (3) the courses are taught by one of the institution's instructors; and (4) the program is located at the institution's main campus, approved additional location, another location approved by the state or accrediting agency, or an employer facility. Items 2-4 are significant changes and will impact currently acceptable 90/10 solutions. These proposed amendments to the rule add thresholds to the existing, requirement that these type of courses and programs meet one of the following: (a) be approved or licensed by the appropriate State agency; (b) be accredited by an accrediting agency recognized by ED; (c) provide an industry-recognized credential or certification; (d) provide training needed for students to maintain State licensing requirements; or (e) provide training needed for students to meet additional licensing requirements for specialized training for practitioners that already meet the general licensing requirements in that field. The proposal is intended to create an additional guardrail for ineligible programs that do not necessarily have the same consumer protection mechanisms as Title IV-eligible programs and to decrease the incentive to create ineligible programs that would contribute to the 10 side.
- **Disallowing proceeds from the sale of accounts receivable and loans as "revenue":** The proposed rule expressly prohibits counting any amount of the proceeds from the sale of accounts receivable or institutional loans as revenue.
- **Prohibiting delayed disbursements:** The NPRM would expressly prohibit delaying Title IV disbursements to the next fiscal year. Although this practice was generally criticized in the past, the NPRM would make the prohibition explicit by requiring the institution to request and disburse Title IV funds to students by the end of the institution's fiscal year.
- **Public disclosure of 90/10 failure:** In the event an institution fails to satisfy 90/10 in any single fiscal year, the proposed rules require the institution to disclose this to students at the end of the current fiscal year with an explanation that the school could lose Title IV eligibility if it fails a second year.
- **Clarity on revenue generated from income share agreements:** The NPRM specifies how institutions must treat income share agreements when the agreement is with the institution or a related party. Those requirements include having only cash payments representing principal payments that were used to satisfy tuition, fees and other non-federal revenue charges. The proposed provision would also prohibit the sale of income share agreements from being included as non-federal revenue. The goal for ED is to remove the incentive for proprietary institutions to encourage students to take out unclear credit products for schooling.

Change of Ownership/Control

The NPRM modifies the process for implementing a change in ownership or a change in control, and amends the thresholds for what constitutes (i) a reportable change and (ii) a change in control that must be approved by ED. In addition, this rule package makes certain definitional changes, including ? notably ? implementing a more stringent

approach to what constitutes a “nonprofit.”

In both the Neg Reg hearings and the preamble to NPRM, ED indicated its changes generally reflect the increasing complexity of institutional ownership structures, an increasing number of applications for changes in control and an increasingly detailed ED review. A number of the changes reflect processes and procedures that ED is already implementing in practice.

The key proposed changes include the following:

- **New Definition of “Nonprofit Institution”:** The NPRM makes important updates to the definition of “nonprofit institution,” and enhances the requirements an institution must meet to be viewed as nonprofit by ED, regardless of its 501(c)(3) status. Although this change was likely driven by concerns around proprietary institutions converting to nonprofit status, it applies to all nonprofit institutions, including traditional universities.

The proposed changes are intended to ensure that no part of a nonprofit institution's net earnings benefit any private entity or natural person. In making this determination, ED proposes it will have broad authority to consider “the entirety of the relationship between the institution, the entities in its ownership structure and other parties.” ED identifies a number of example arrangements that would generally prevent an institution from operating as a nonprofit, although ED retains discretion to evaluate the individual relationships.

Examples of presumptively prohibited arrangements for a nonprofit institution include when the institution:

- Owning a debt to a former owner or an affiliate of the former owner
- Entering a revenue-sharing agreement (either directly or indirectly) with a former owner, current or former employee of the institution, or member of its board, or an affiliate of any of those entities.
- Entering any agreement, including lease agreements, with a former owner, current or former employee of the institution, or a member of its board, or any affiliate of those entities.
- Engaging in an excess benefit transaction with any natural person or entity

The institution may be able to demonstrate to ED that any of the listed arrangements are “reasonable,” based on the market price and terms for such services or materials, and the price bears a reasonable relationship to the cost of the services or materials provided.

Importantly, ED may evaluate these contracts during recertification of any nonprofit institution's eligibility to participate in Title IV or any other time the information becomes available to ED, such as if there is an IRS or state action. These types of arrangements are currently reviewed by ED if an institution applies to convert from for-profit to nonprofit status, but historically were not reviewed following the conversion, raising the possibility that a previously converted for-profit could be treated as a for-profit for ED purposes at some point in the future.

- **Require 90 days’ notice to ED and notice to students prior to a change in ownership:** The proposed rule would require institutions submit a pre-acquisition review notice, including an Electronic Application, state and accreditor approvals, and financial statements, at least 90 days before a change in control. Although most parties currently submit a pre-acquisition application under ED’s existing rules, such a pre-transaction review by ED is optional. Under the proposal, the parties would not be required to wait for ED’s approval to complete a transaction, but they would be required to wait at least 90 days from submission of the pre-acquisition application to close a deal. The proposed regulation also emphasizes that ED can decide not to approve a transaction. Importantly, the proposal also requires an institution to notify its enrolled and prospective students at least 90 days prior to a proposed change in control.
- **Changes in reporting thresholds for a “change in ownership” and a “change in control”:** ED is proposing a number of definitional changes that impact what events constitute a change in ownership and what events constitute a change in control. These changes will modify which types of changes require approval from ED, and which changes must simply be reported to ED (with no approval required).
 - *Reportable Changes*
 - Within ten days of the change, institutions must report any change by which a person or entity acquires at least a 5% ownership interest.
 - When a person or entity, alone or with other affiliated persons or entities, acquires at least 25% ownership of an institution; a natural person becomes a general partner, managing member, trustee or co-trustee, or officer of an entity that has at least 25% ownership interest; or an entity becomes a general partner or managing member of an entity with at least a 25% ownership

interest, it is considered a reportable change of control.

- *Changes in Control Requiring Approval*

- The NPRM proposes to move the threshold for changes in control that require ED approval from the current standard of 25% of voting interest and control to 50% of voting interest and control. However, the proposal also expands and specifically lists a number of scenarios that would fall into the change of control category, including, among others:
 - Acquiring 50% of voting interest or otherwise acquiring 50% control
 - Ceasing to hold 50% of voting interest or otherwise ceasing to hold 50% control
 - A partner in a general partnership (GP) acquiring or ceasing to own at least 50% of the voting interest in the GP
 - Any change in the general partner of a limited partnership, if the GP has an equity interest in the school
 - Any change in the managing member of an LLC, if the managing member has an equity interest in the school
 - A person becoming the sole member or shareholder of an LLC or other entity that has an indirect interest in the school
 - The addition or removal of any entity that provides/will provide audited financial statements to ED
- In determining “control,” the NPRM indicates ED will consolidate interests among commonly owned, managed, or controlled entities, or those that vote together through an agreement or proxy arrangement.

- **Codify current practice for new owners without acceptable financial history:** As has long been department practice, the NPRM formalizes ED’s expectation that if a new owner is unable to provide two fiscal years of audited financial statements in connection with a change in control application, ED will require the institution to post a letter of credit of at least 25% of the institution’s prior year Title IV volume. If only one year of acceptable audited financial statements is available, ED will require a letter of credit in the amount of 10% of prior year Title IV volume. Importantly, if an entity in the ownership structure holds a 50% or greater voting or equity interest in another institution, ED is proposing that it may combine the Title IV volume of **all institutions** under such common ownership when calculating the letter of credit amount.

What’s Next

ED is accepting public comments on these proposals until August 26, 2022. We encourage all interested parties to consider submitting comments addressing their concerns with the proposed language. [Comments can be submitted here.](#)

Following the close of the comment period, ED will review the public feedback before it issues its final rules. ED is likely to issue its final rules no later than November 1, 2022, in order to meet its master calendar requirements, which require publication of a final rule by November 1, 2022 for the rule to take effect July 1, 2023. Rules that do not meet the November 1 publication deadline will take effect the following July 1, which therefore pushes the implementation of the rule another year. ED delayed publication of the remaining topics from the 2022 Neg Reg, which include Ability to Benefit, Administrative Capability, Gainful Employment, Financial Responsibility, and Certification Procedures. We anticipate ED may revisit those proposals in 2023.

We will continue to track developments and will provide additional updates as they become available.

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