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Trick or Treat? U.S. Department of Education Publishes Final Gainful Employment Regulations

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Trick or Treat? U.S. Department of Education Publishes Final Gainful Employment Regulations

The U.S. Department of Education published final regulations concerning gainful employment and institutional eligibility for Title IV federal student aid in the *Federal Register* on October 31, 2014.[1] The new regulations define gainful employment based on whether students are left with unaffordable levels of loan debt as compared with their earnings after they complete the program.

The final rule is 945 pages in length, up from the 841 pages in the Notice of Proposed Rulemaking (NPRM) that was published in the *Federal Register* on March 25, 2014. The U.S. Department of Education received about 95,000 public comments on the NPRM.

Since the final rules were published before November 1, 2014, the new regulations will become effective on July 1, 2015.

Major Changes in Final Gainful Employment Regulations

The final rule drops the programmatic cohort default rates (pCDR) as an accountability metric, but retains them as a potential disclosure. This change means that institutional eligibility under the gainful employment rules will be based *solely* on the debt and earnings of students who complete the program. The performance of students who drop out will not be considered or evaluated.

The final rule retains the debt-service-to-earnings ("annual earnings rate") and debt-service-to-discretionary-earnings ("discretionary income rate") ratios that appeared in the NPRM.

- The debt service is calculated based on median debt, after capping each student's debt based on tuition, fees, textbooks, supplies and equipment. This excludes debt that was incurred for living expenses such as room and board.
- Annual earnings are based on the higher of the mean or median, as reported by the Social Security Administration (SSA).
- If SSA is unable to report earnings for some of the students in the cohort, a corresponding number of the highest loan debt figures will be excluded before calculating the median debt.
- Discretionary earnings will be based on the poverty line for the calendar year immediately following the calendar year for which earnings data is obtained from SSA.
- The interest rates for calculating the annual loan payment will be based on the average of the annual statutory interest rates on the unsubsidized Federal Stafford loan for undergraduate and graduate programs that were in effect during the three-year or six-year period prior to the end of the cohort period.

[1] 79 FR 64889-65103, October 31, 2014. https://federalregister.gov/a/2014-25594

- The annual loan payments will be based on an amortization period of 10 years for certificate and Associate's degree programs, 15 years for Bachelor's and Master's degree programs and 20 years for doctoral and first professional degree programs.

These Debt-to-Earnings (D/E) rates measures have pass thresholds that are similar to the ones that were included in the NPRM.

- The debt-service-to-earnings ratio must be equal to or less than 8 percent and the debt-service-to-discretionary-earnings ratio must be equal to or less than 20 percent for a program to be considered as passing the D/E rates measure.
- Programs for which the debt-service-to-earnings ratio is over 12 percent and the debt-service-to-discretionary-earnings ratio is over 30 percent are considered as failing the D/E rates measure.
- All other programs are in the "zone."

There is very little a program can do to move from the zone to a passing status other than drastically cutting tuition and fees, changing admissions standards or subjecting students at risk of high debt to intensive financial and academic counseling.

The gainful employment regulations suggest that programs could pay down the debt of completers to come into compliance with the D/E rates measures. Colleges could selectively provide scholarships or pay down the debt of students with projected debt levels at or below the median in order to shift the median. However, section 435(m)(2)(B) of the Higher Education Act of 1965 [20 USC 1085(m)(2)(B)] precludes colleges from making a payment on a borrower's loan in order to avoid default by the borrower.

A program will lose eligibility for federal student aid if it fails the D/E rates measure in two out of three consecutive award years or persists in the zone or with a mix of zone/failing statuses for four consecutive award years.

The final regulations dropped an exception for low-risk programs, where a majority of students do not borrow. However, the reliance on median debt in the D/E measures provides an implicit waiver for programs where more than half of the completers do not borrow, since the median debt will be zero for these programs.

The U.S. Department of Education argues that the four-year tolerance for programs in the zone accommodates variations in labor markets during an economic downturn. They cite data from the National Bureau of Economic Research that indicate that since 1945, recessions last an average of 11.1 months. But, this is an average duration, not the maximum duration of a recession. The current economic downturn has lasted for more than four years.

The new regulations drop provisions calling for financial relief to borrowers enrolled in programs that become ineligible for federal student aid.

Most of the other changes are clarifications. For example, the new regulations clarify that the total amount borrowed for a gainful employment program is the total amount disbursed minus cancellations and adjustments. Some of the clarifications eliminate potential loopholes.

The U.S. Department of Education is creating an interagency task force to coordinate federal and state oversight of for-profit colleges, replacing an informal working group.

New Regulations are Harsher than 2011 Regulations

The new gainful employment regulations are harsher than the 2011 final rule in two main ways:

- The lower pass thresholds in the new regulations require 50% greater average earnings from a program's completers for the program to pass the D/E rates measures.
- A program must pass both the debt-service-to-earnings ratio and the debt-service-to-discretionary-earnings ratio to pass the D/E rates measure, unlike the 2011 final regulations, where a program could pass either ratio.

The debt-service-to-discretionary-earnings ratio adds no information on top of the debt-service-to-earnings ratio, as all programs that have a passing debt-service-to-discretionary-earnings ratio also have a passing debt-service-to-earnings ratio. So, it is unclear why the U.S. Department of Education retained the debt-service-to-discretionary-earnings ratio in the final rule, since dropping it would not affect the outcomes of the new gainful employment rule. (Perhaps, the U.S. Department of Education expects the lower pass thresholds to be overturned by the courts, and decided to retain the debt-service-to-discretionary-earnings ratio language in case such a change occurred?)

Since the rule proposed in the NPRM would have required programs to pass both the pCDR and the Debt-to-Earnings (D/E) rates measures, dropping the pCDR requirements makes the final rule weaker than the proposal that appeared in the NPRM. Nevertheless, the final rule is harsher than the 2011 gainful employment regulations.

Addressing the Backward-Looking Nature of the Debt Measures

The debt-to-earnings (D/E) rates calculate the ratio of annual loan payments to annual earnings and to annual discretionary earnings for a cohort of students who completed the program. The D/E rates will normally be based on a 2-year cohort, which is the third and fourth award years prior to the award year for which the D/E rates are calculated. (The 2-year cohort will be the sixth and seventh award years prior to the award year for which the D/E rates are calculated if the student graduated from a program that requires a medical or dental internship or residency.)

If there are less than 30 students completing the program during the 2-year cohort, the D/E rates will be based on a 4-year cohort, consisting of students completing the program during the third, fourth, fifth and sixth years prior to the award year for which the D/E rates are calculated. The D/E rates will not be

calculated if the earnings data provided by the Social Security Administration (SSA) is based on fewer than 30 program completers.

Accordingly, the gainful employment regulations are necessarily backward-looking. To address the backward-looking nature of the D/E rates, the U.S. Department of Education will use a 5-7 year transition period to ensure that there is enough time for programs to improve their compliance with the new gainful employment regulations. The transition period is five years for programs of one year or less in duration, six years for programs of one to two years in duration and seven years for programs that are longer than two years.

During the transition period, the U.S. Department of Education will calculate two D/E rates. The alternative D/E rate will base the median loan debt using completers during the most recent award year instead of the median loan debt for the two-year cohort. The intention is to allow the D/E rates to reflect reductions in median loan debt during the transition period. The U.S. Department of Education claims that most of the students in the 2-year cohort will have begun their programs *after* the final regulations are published, giving the colleges an opportunity to reduce the students' debt by lowering their tuition and fees.

The median debt figures are capped based on each student's tuition, fees, books, supplies and equipment. Accordingly, reductions in tuition and fees may cause a reduction in the median debt figures used in the D/E rates, even though colleges have limited authority to directly reduce student debt. In practice, every dollar reduction in tuition correlates with a 30-cent reduction in debt at graduation.

The transition period operates in conjunction with the zone. If a program immediately cuts costs enough to shift from a failing status to the zone, it can persist for four years in the zone before it will lose eligibility for federal student aid.

The U.S. Department of Education claims that programs in the zone would need to reduce the median annual loan payment by 16%, on average, to obtain a passing D/E rate.

There are several flaws in the definition of the transition period that may affect the ability of certain programs to influence the median debt figures.

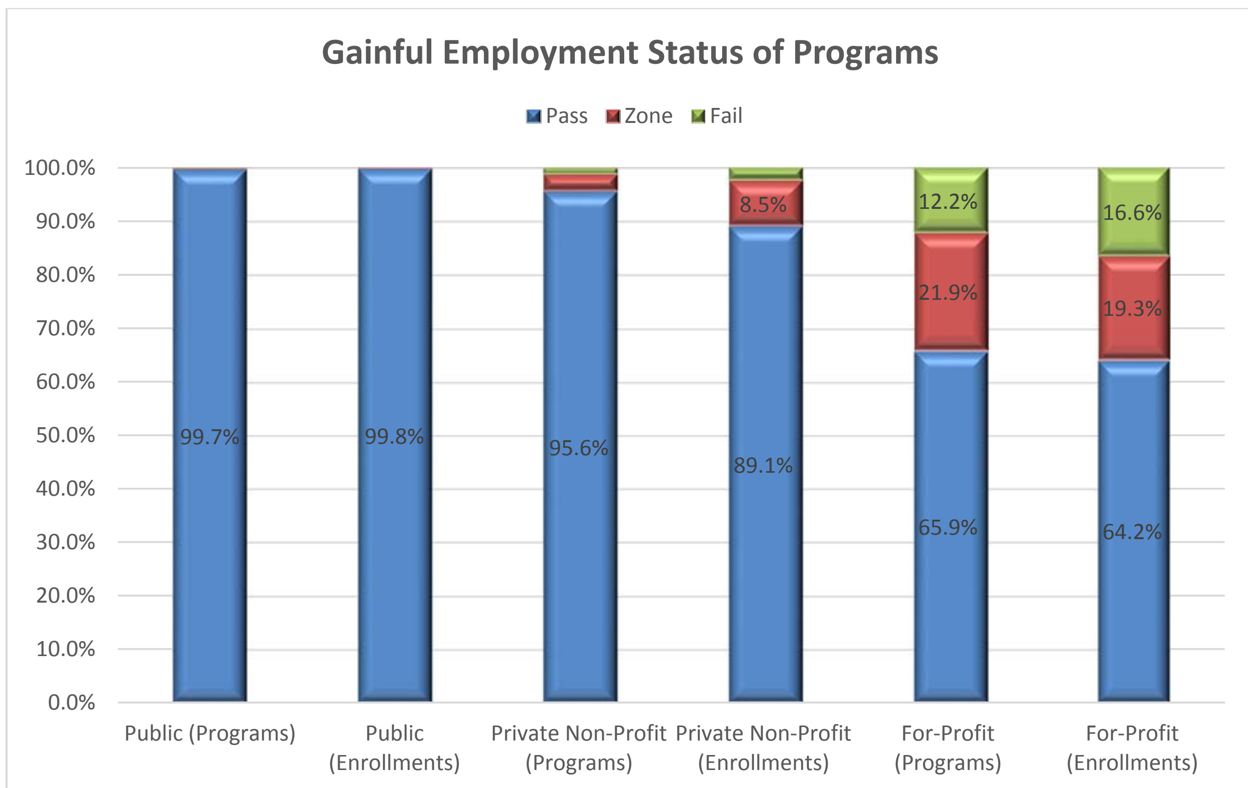
- Bachelor's degree programs are typically four or five years in duration, yet the transition period is only one year longer for these programs than for two-year programs.
- Small programs with fewer than 30 completers will have D/E rates based on a four-year cohort, yet have the same transition period as programs for which the D/E rates are based on a two-year cohort.

Impact of the New Regulations on Program Eligibility

The U.S. Department of Education estimates that about 1,400 programs will lose eligibility for federal student aid, up from 193 in the 2011 final regulations.[2] About 840,000 students are enrolled in these programs. (The total programs in the zone and failing in Table 2.21 of the final regulations is 1,445, corresponding to a total enrollment of 841,667. So, the number of programs transitioning into a passing status is a very small percentage of the total number in the zone and failing.) More than 99% of the students enrolled in the affected programs are at for-profit colleges.

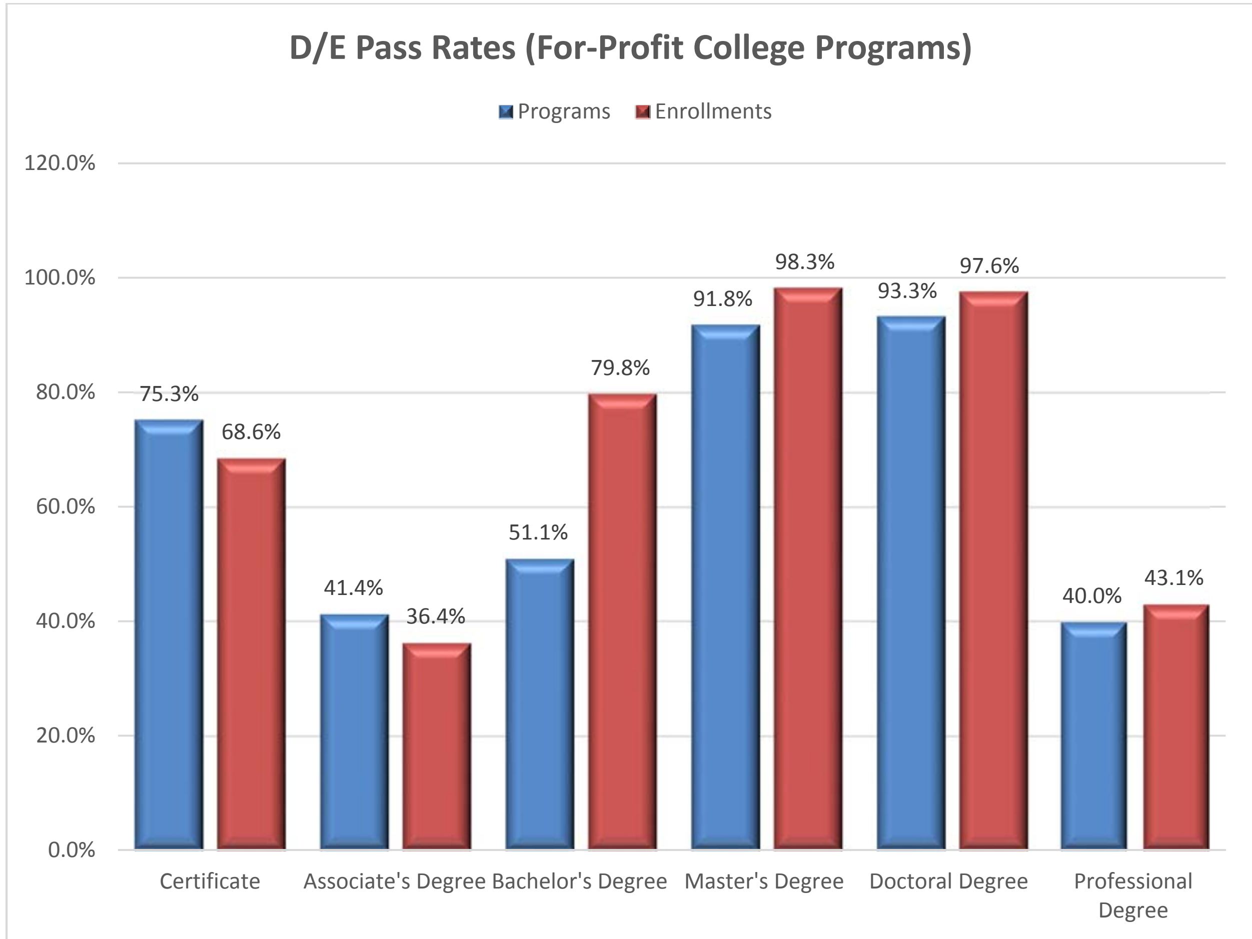
Based on 2012 data, 73.9% of the overall programs will pass, 16.8% will be in the zone and 9.3% will fail. Weighting the data by enrollment calculates the percentage of students that are affected, based on their enrollment in an affected program. When these results are weighted by enrollment, 66.6% of students are enrolled in programs that will pass, 18.0% are enrolled in programs that will be in the zone and 15.4% are enrolled in programs that will fail.

As the next table shows, the new regulations almost exclusively affect programs at for-profit colleges, with almost all programs at public colleges and private non-profit colleges passing, compared with two-thirds of programs at for-profit colleges. More than a third of programs at for-profit colleges have a failing status or are in the zone, regardless of whether the figures are weighted by enrollment or not.



[2] Obama Administration Announces Final Rules to Protect Students from Poor-Performing Career College Programs, U.S. Department of Education, Press Office, October 30, 2014.

The next chart shows the percentage of programs and enrollments that pass the D/E rates measures by credential level. Enrollment weighting of the percentages causes a significant shift in the pass rates among Bachelor's degree programs, suggesting that the more successful programs have higher enrollments.



When weighted by enrollment, 25.1% of programs in the zone or failing are certificate programs, 58.9% are Associate's degree programs and 15.0% are Bachelor's degree programs.

Enrollment weighting can demonstrate a big shift in the impact. While 70.9% of passing programs at for-profit colleges are certificate programs, 14.6% are Associate's degree programs and 7.6% are Bachelor's degree programs, weighting the percentage of passing programs by enrollment shifts the distribution to 28.6%, 33.2% and 26.5%, respectively.

Of the students who are enrolled at programs that will be in the zone or failing, about a third (32.3%) do not have a nearby transfer option to an in-person program with the same six-digit Classification of Instructional Programs (CIP) code and credential level. This suggests that a significant number of students enrolled in gainful employment programs that lose eligibility for federal student aid will not continue their postsecondary education.

The programs that are most frequently in the zone or failing include:

- medical assistant
- cosmetology
- medical records
- behavioral sciences
- computer systems networking and telecommunications
- culinary arts
- criminal justice
- electrical technician
- teacher's aide
- human services

The U.S. Department of Education presents an analysis in the final rule that claims that Federal Pell Grant recipients and minority students will not be disproportionately impacted by the final gainful employment rule. This analysis effectively overfits the data at individual programs, ignoring the broad trends that correlate well with these demographic variables. The significant variation among colleges that have a similar percentage of Federal Pell Grant recipients or minority student enrollment indicates that there are other significant factors that can influence pass rates. These differences may include other demographic risk factors, the programs that are offered by the college and the economy and job market in the area surrounding the college. But this does not obviate the broad trend that programs that enroll more Federal Pell Grant recipients and minority students are more likely to be affected by the gainful employment regulations.

Court Challenge is Very Likely

For-profit colleges are very likely to file suit to block and overturn the new gainful employment regulations.

A lawsuit to overturn the final regulations is likely to prevail, because the new regulations are arbitrary, capricious and represent an abuse of discretion [5 USC 706(2)(A)].

- The new rules are much harsher than the 2011 final rule, requiring 50% greater earnings by a program's graduates for the program to pass the D/E rates measures. Yet, the U.S. Department of Education failed to demonstrate why there is a need for much stricter rules. The for-profit colleges might be able to argue that the 2011 rules are evidence that the 12% and 30% passing thresholds were considered sufficient just three years ago, and that nothing has changed for the worse since the 2011 rules were published. The U.S. Department of Education may not be able to counter that it retained these thresholds in the zone, as a program cannot persist indefinitely in the zone and most such programs will lose eligibility for federal student aid. The lack of a reasoned basis for stricter regulation may be sufficient grounds for the new regulations to be overturned.

- The new regulations disproportionately affect programs at for-profit colleges, with almost no impact on programs at public colleges and private non-profit colleges. Programs at for-profit colleges represent 75.7% of all gainful employment programs and 67.5% of passing programs, but 98.9% of programs in the zone and 99.2% of failing programs. As noted in the final regulations, "Almost all programs that would fail or fall in the zone were at for-profit institutions." This suggests that the new rules were designed to achieve a particular outcome, rather than having a reasoned basis.