MEMORANDUM OF KAPLAN, INC. FOR THE OFFICE OF INFORMATION AND REGULATORY AFFAIRS REGARDING THE GAINFUL EMPLOYMENT RULE

Kaplan, Inc. submits this memorandum in aid of OIRA's review of the "gainful employment" rule proposed by the Department of Education. Kaplan currently serves 92,000 students in postsecondary programs on more than 70 campuses throughout the nation and through Kaplan University's online programs. For the reasons stated below, we submit that the proposed rule published in the Federal Register on July 26, 2010 is not "consistent with applicable law, the President's priorities, and the principles set forth in . . . Executive Order [12866]," as amplified by Executive Order 13563. Ex. Order 12866, § 6(b).[1] In particular:

1. The rule is inconsistent with the Higher Education Act of 1965 ("HEA")—in particular, with the HEA's definition of a proprietary institution, its cohort default provision, and the alternative loan repayment options authorized by Congress and the Department.

2. The rule is at odds with the President's goal of increasing substantially the number of college graduates.

3. The rule creates uncertainty by subjecting proprietary institutions to sanctions on the basis of data to which they do not have access and over which they have no control.

4. There are better ways to achieve the President's goal of increasing college graduates while simultaneously protecting students and the public fisc.

1. The Gainful Employment Rule Is Inconsistent with the HEA

The Higher Education Act of 1965 (the "HEA" or the "Act"), 20 U.S.C. § 1001 *et seq.*, authorizes federal financial assistance to students for post-secondary education. Students may use federal financial assistance provided under Title IV of the Act to pay for tuition and other costs at a variety of public and private institutions—including "proprietary institutions of higher education," which are defined as for-profit institutions that "provide[] an eligible program of training to prepare students for gainful employment in a recognized occupation." 20 U.S.C. § 1002(b)(1)(A)(i). The Department has seized upon the phrase "gainful employment," which is undefined in the HEA, to impose onerous regulations on "proprietary" institutions that Congress never intended or authorized.

[1] *See* 75 Fed. Reg. 43616. The arguments set forth in this memorandum apply to the basic thrust and structure of the rule; they are applicable even if some of the details have been altered.

a. The "gainful employment" rule would require proprietary institutions not only to "prepare" students for gainful employment—as the statute requires—but also to make sure that their students actually obtain employment at certain income levels and/or repay the principal on their federal loans at certain rates.[2] There is no basis for these requirements in the provision upon which the Department relies. That provision is a definitional one: it defines the term "proprietary institution." And it does so by reference to the institution's "program of instruction," not to some future loan repayment rate or income level. It is inconsistent with the nature of that definition to make it dependent upon such future events, particularly when, as in this case, the events are wholly unrelated to the quality of program instruction and beyond the control of the institution. An institution cannot guarantee students employment at a certain income level—it doesn't control unemployment levels or any of the other economic trends that determine wage levels. Nor can an institution control the loan repayments of its students—especially those who drop out (they too are included in the rule's repayment rate calculations). Neither of these metrics has anything to do with the nature or quality of the institution—whether it "provides an eligible program of training to prepare students for gainful employment in a recognized occupation." The term "gainful employment" obviously means no more than a paying job; it does not mean a job that pays any particular amount. In short, the gainful employment rule stretches the statutory language beyond anything that Congress can reasonably be thought to have intended or authorized.

b. The requirements of the "gainful employment" rule are also inconsistent with other provisions of the HEA that were adopted to accomplish the very purposes that the Department invokes to support the rule. The HEA provides that an educational institution may lose its eligibility to receive Title IV funds if its students default in their repayment of Title IV loans at a rate that exceeds a statutorily prescribed "cohort default rate." The cohort default rate measures the percentage of current or former students who default on federal loans within a three-year (formerly two-year) period after the student is to begin making federal loan payments. *See* 20 U.S.C. § 1085(m)(1)(A).[3] If that default rate exceeds a certain percentage—eventually 30 percent,

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[2] To retain full eligibility to participate in the Title IV program without restrictions, a proprietary institution would have to satisfy one of three new metrics—(1) its former students must post a repayment rate of at least 45 percent, or (2) its graduates must have an annual loan payment-to-earnings ratio of no greater than 8 percent, or (3) its graduates must have an annual loan payment-to-discretionary income ratio of no greater than 20 percent. A program would be ineligible to receive Title IV funds if it had a repayment rate below 35 percent, a debt payment-to-income ratio over 12 percent, and a debt payment-to-discretionary income ratio over 30 percent. Programs that fall in between these extremes would be allowed to receive Title IV funds on a "restricted" status.

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historically 25 percent—for three successive years, the institution is no longer eligible to receive Title IV funds, absent a successful appeal to the Secretary. *Id.* § 1085(a)(1).[4] The cohort default rate is the statute's sole determinant of when a proprietary institution may be sanctioned for its students' loan repayment record.

The "gainful employment" rule would effectively displace the statutorily prescribed "cohort default rate" test and substitute new, more stringent standards to assess the adequacy of students' debt repayment. It would disqualify programs that are eligible to participate under the Act's cohort default rate provision, based on two substantially different criteria: (1) a weighted percentage of outstanding loans to students that have had their principal balance reduced during the year; and (2) the ratio of annual debt service payments to annual and discretionary income of a program's graduates.

Unlike the cohort default rate, which penalizes a school based only on its former students' defaults, the gainful employment rule would disqualify schools when their former students are not in default at all—when they are in full compliance with repayment programs explicitly authorized by Congress. Various provisions of the HEA allow borrowers to defer principal payments based on economic hardship, enrollment in a graduate course of education, or military service.[5] Students who qualify for forbearance or deferment of principal payments are not deemed to have "defaulted" on their obligations for the purposes of the HEA's cohort default rule. But those students are counted as not repaying under the gainful employment rule, because they would not be reducing the principal amount of their loans. The gainful employment rule, therefore, conflicts with the cohort default rule and undermines repayment programs that Congress authorized for the protection of students in times of financial need. These programs promote the overall policies of the HEA by affording temporary relief to

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[4] The two-year cohort default rate remains in effect for enforcement purposes until the year 2014.

[5] The HEA allows students to defer making payments of principal while pursuing graduate education, during periods of military service, and for up to three years during periods of unemployment or "economic hardship." 20 U.S.C. §§ 1077(a)(2)(C), 1087e(f), 1087dd(c)(2)(A); *see* 34 C.F.R. §§ 674.34, 682.210, 685.204. Under the statute, a borrower is deemed to be in a period of "economic hardship" if, *inter alia*, he "is working full-time and is earning an amount which does not exceed . . . an amount equal to 150 percent of the poverty line applicable to the borrower's family size." 20 U.S.C. § 1085(o). The HEA further provides for forbearance—temporary cessation or reduction of payments or extensions of time for making payments—if, *inter alia*, a borrower has a debt that equals or exceeds 20 percent of income, is serving in a national service program, or is eligible for interest payments to be made for service in the Armed Forces. 20 U.S.C. § 1078(c)(3), 1087dd(e); *see also* 34 C.F.R. §§ 674.33(d), 682.211, 685.205. The HEA also authorizes income-based repayment plans that cap annual payments for students who experience "partial economic hardship" at 15 percent of the amount by which the borrower's adjusted gross income exceeds 150 percent of the poverty line. 20 U.S.C. § 1098e(a)(3). If the interest due on the borrower's loan exceeds that amount, principal payments may be deferred indefinitely. *Id.* § 1098e(b).

students facing financial pressure. The HEA's cohort default rule respects these policies by not counting students in deferral or forbearance programs as being in default. By contrast, the repayment rate test contained in the gainful employment rule undermines these policies by counting students in deferral or forbearance as not repaying their loans.[6]

Congress is well aware of the fact that its deferment and forbearance programs have the effect of lowering participating institutions' cohort default rates. In 2003 a report of the Department's Office of Inspector General analyzed this effect and recommended that borrowers in deferment and forbearance be excluded from the default rate calculation—in practice, the principal effect of the gainful employment rule.[7] Congress did not accept that recommendation—although it did later follow another recommendation in the same OIG report to extend the then two-year period within which defaults are captured.[8]

The gainful employment rule is inconsistent with the HEA in other respects as well. Under the HEA, an institution is ineligible to receive Title IV aid on behalf of a student if its cohort default rate exceeds the statutory limit ***for three successive years***.[9] Under the gainful employment rule, a program can lose its eligibility if it fails to meet the prescribed debt-to-income and repayment measures ***for a single year***. Moreover, under the HEA, the Secretary is authorized to excuse an institution that fails the cohort default rate test upon a finding of "exceptional mitigating circumstances," which exist if (i) two-thirds of the students enrolled on at least a half-time basis are eligible to receive one-half the maximum Pell Grant or have incomes below the poverty level, and (ii) in the case of degree programs, 70 percent of the students completed their programs on time, transferred, remained enrolled or entered military service, or (iii) in the case of

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[6] The inconsistencies between the gainful employment rule and the cohort default provision of the HEA are compounded when one examines in detail how the two treat the issue of economic hardship. The HEA requires the Secretary to consider low incomes and high debt-to-income levels "as primary factors" in granting "economic hardship" deferments, which in turn reduce an institution's cohort default rate and preserve its eligibility. 20 U.S.C. § 1085 (m). By contrast, the gainful employment rule uses low incomes and high debt-to-income levels to render an institution ineligible.

[7] Office of Inspector General, Audit to Determine if Cohort Default Rates Provide Sufficient Information on Defaults in the Title IV Loan Programs, ED-OIG/A03-C0017, at 20-27 (Dec. 2003).

[8] *Id.* at 9-19. *See* Higher Education Opportunity Act of 2008, P.L. 110-315, 122 Stat. 3295 (Aug. 14, 2008) (extending the period during which defaults are captured from two to three years starting in fiscal year 2012).

[9] The default rate regulations also provide for the loss of Federal Direct Loan Program eligibility based upon a default rate exceeding 40 percent for just one year. 34 C.F.R. §§668.187(a)(1) and 668.206(a). The one-year trigger is not only significantly higher than the three-year trigger; it also does not bar eligibility for all federal student aid programs, as the three-year threshold does and the gainful employment rule would.

non-degree programs, the school had placed 44 percent of the students originally scheduled to complete their program during the year. 20 U.S.C. § 1085(a)(5), The gainful employment rule contains no such provision for avoiding the impact of its repayment and debt-to-income requirements.[10]

The Department has authority to interpret and implement the HEA. But it does not have authority to promulgate a regulation that alters the statutory definition of a "proprietary institution of higher education," that conflicts with the HEA's cohort default provision, and that fails to take account of the deferment and forbearance programs authorized by Congress to modify borrowers' repayment obligations. In all of these respects, the gainful employment rule is "[in]consistent with applicable law." Ex. Order 12866, § 6(b).

2. The Gainful Employment Rule Undermines the President's Priorities

President Obama has set a goal of leading the world in the percentage of college graduates by 2020—the United States now ranks #12.[11] The Department acknowledged that goal—and the importance of the for-profit sector in achieving that goal—when it proposed the gainful employment rule: "[f]or-profit postsecondary education . . . has long played an important role in the nation's system of postsecondary education and training," and "President Obama's goal of leading the world in the percentage of college graduates by 2010 . . . cannot be achieved without a healthy and productive higher education for-profit sector." 75 Fed. Reg. 43617.

At a time when state and local governments—the chief sponsors of community colleges and nonprofit vocational institutions—are facing considerable financial difficulties, proprietary institutions have stepped in to fill the gap, providing educational opportunities for millions of students who otherwise would have been without options. Proprietary institutions play a particularly important role in providing educational opportunities for the segment of the population that needs to be

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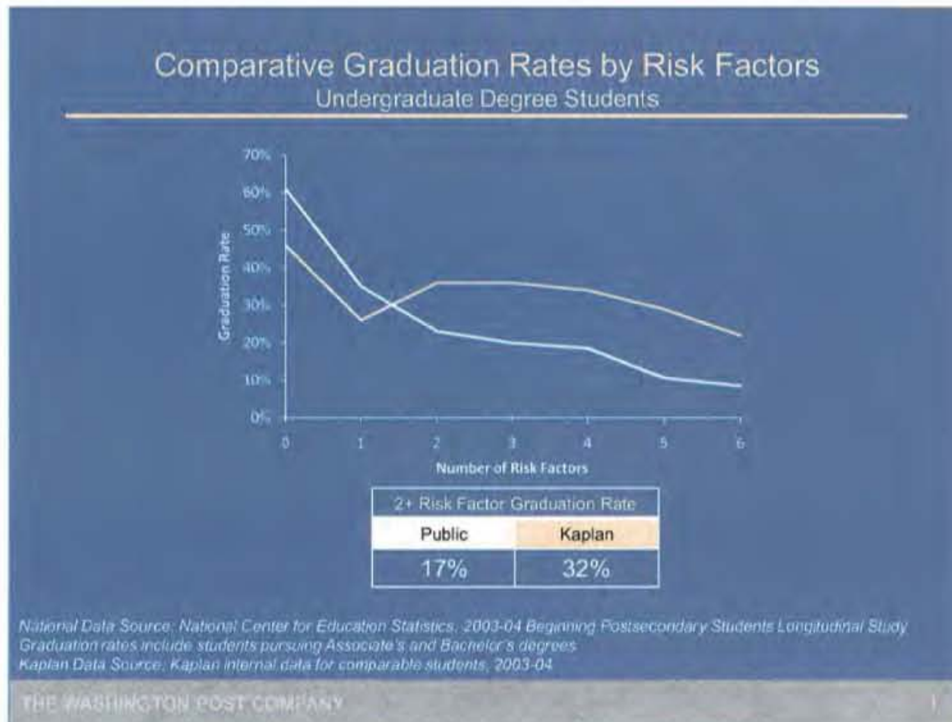
[10] There is still another inconsistency: the debt-to-income test of the gainful employment rule is premised on ***predicted*** default rates, rather than the ***actual*** default rates that the cohort default rate measures. The Notice of Proposed Rulemaking explains that "[d]ebt service rates have a connection to whether borrowers will default on their loans," and that "[b]orrowers with rates above the 8 percent threshold [for full eligibility under the gainful employment rule] have a default rate of 10.2 percent, compared to a rate of 5.4 percent for those below the threshold." "Borrowers with debt rates above the 12 percent threshold [that triggers restrictions or ineligibility]," the Notice continued, "have a default rate of 10.9 percent." 75 Fed. Reg. 43618. In other words, the gainful employment rule renders a program potentially ineligible based on a ***predicted*** or ***expected*** default rate of roughly 10 percent, whereas the cohort default rule renders a program eligible as long as its ***actual*** default rate is below 30 percent.

[11] Organization for Economic Co-Operation and Development, *Education at a Glance 2010*, Table A1.3a, available at http://dx.doi.org/10.1787/888932310092.

brought into the college ranks if the President's goal is to be achieved—non-traditional students who work full time, have dependent children, or whose pursuit of higher education has been delayed by military service, financial difficulties or family circumstances. To illustrate this point: the average Kaplan undergraduate student arrives with four of the seven graduation risk factors that have been identified by the Department of Education, compared to the national average of 1.5.[12]

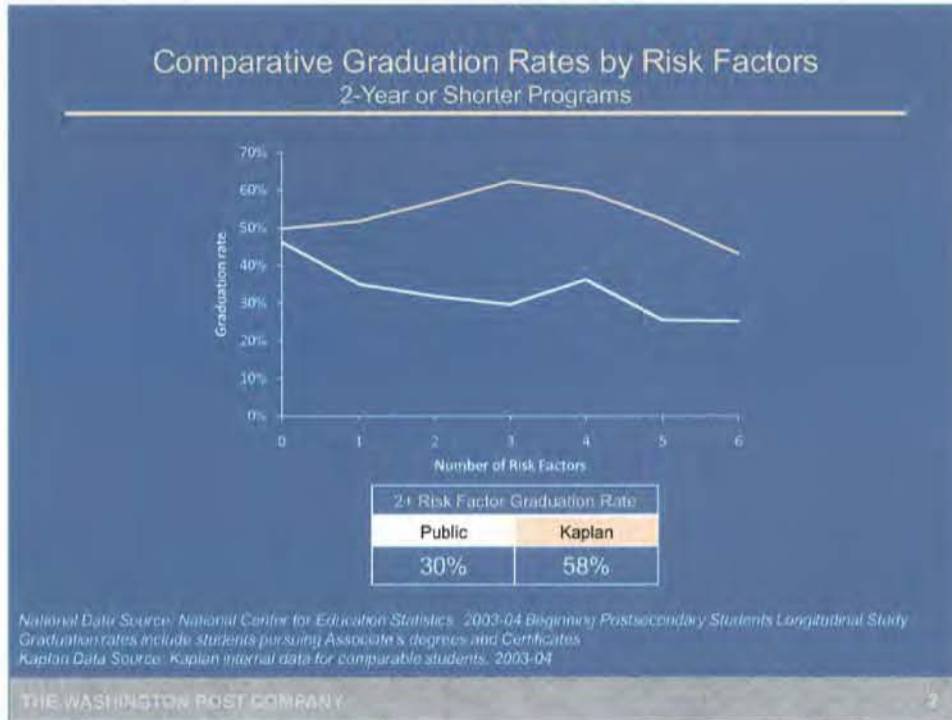
For-profit schools like Kaplan not only attract a higher percentage of these at-risk students; they do a superior job of graduating them. Below is a graph that compares the graduation rate of undergraduate degree students (Associate's and Bachelor's degrees) at Kaplan with the national average at all colleges and universities (public, non-profit, and for-profit). It shows that among undergraduate students with two or more risk factors—the kind of student that Kaplan serves— Kaplan students graduate at a rate that is almost two times the national average (32 percent at Kaplan versus and a national average of 17 percent).[13]



[12] These graduation risk factors are: delayed enrollment (the student is older); full-time work; part-time school attendance; lack of parental support; legal dependents; lack of high school diploma; and single parent status.

[13] The analyses reflected in the two graphs in the text are based on a 2003 student cohort interviewed at years one, three and six after college entry.

The story is the same among students in programs that are two-years or shorter—students pursuing Associate's degrees and certificates. Here again, as the next graph shows,[14] students with two or more risk factors graduate from Kaplan at a rate that is almost two times the national average (58% at Kaplan versus 30% at public institutions).[15]



Not only do proprietary institutions like Kaplan do a better job of graduating high-risk students; they do so at a lower cost to the taxpayer. The Department appears to assume that the cost to the taxpayer is higher at for-profit institutions because the default rate is higher. But there are at least three flaws in that assumption:

First, default rates are higher at for-profit schools because they serve a higher percentage of low-income students, racial and ethnic minorities, and students who are

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[14] We included only public institutions in this comparison because independent non-profit institutions, for the most part, do not offer Associate's degree and certificate programs.

[15] Other studies show the same thing. *See* Robert J. Shapiro and Nam D. Pham, Taxpayers' Costs to Support Higher Education: A Comparison of Public, Private Not-for-Profit, and Private For-Profit Institutions, at 19 (showing substantially higher graduation rates at 2-year and less-than-2-year for-profit institutions); Roger Lytle, Roger Brinner and Chris Ross, *Parthenon Perspectives on Private Sector Post-Secondary Schools* (March 12, 2010), at 13 (showing significantly higher percentage earnings growth among graduates at 2-year and less-than-2-year proprietary schools). Additional data is summarized in the accompanying Memorandum on the Gainful Employment Rule by Robert Shapiro (Feb. 21, 2011), at 4-5.

first in their immediate families to attend post-secondary schooling.[16] (If the gainful employment rule were applied to Historically Black Colleges and Universities, 95 percent would be ineligible under the repayment rate test.)

Second, a dollar of defaulted debt is not a dollar of debt unpaid. OMB assumes that the government will recover $112 for every $100 of defaulted student debt.[17]

Third, and most important of all, defaulted debt is hardly the most significant educational expenditure that taxpayers incur through their federal and state governments. Community colleges and other public colleges and universities are heavily subsidized by the government. Non-profit colleges and universities also receive government grants of various kinds. A recent study prepared by Robert J. Shapiro (Undersecretary of Commerce for Economic Affairs under President Clinton) and Nam D. Pham compared all of the government support, direct and indirect, provided to private sector for-profit colleges, public colleges, and private non-profit colleges. The study concluded that over the course of a four-year program, public colleges receive six-and-a-half times as much money from the taxpayers on a per-pupil basis ($15,540) as private sector (for-profit) institutions do ($2,394). Even private non-profit colleges receive more taxpayer support on a per-pupil basis ($7,065) than for-profit colleges ($2,394)—in fact, almost three times as much. [18]

In sum, for-profit schools do a better job of graduating at-risk students than public and non-profit institutions, at a fraction of the cost to the taxpayer. They also provide capacity that the public and non-profit schools cannot provide. These are the reasons why they are essential to achieving the President's goal of leading the world in the percentage of college graduates.[19] The gainful employment rule undermines this goal by incentivizing the proprietary sector to turn away the very students who are most in need of the opportunities that they provide—the low-income, high-risk students who are statistically most likely to jeopardize the school's continued eligibility to participate in the Title IV program. If the purpose of Title IV were to save the government money, shrinking the ranks of the proprietary institutions by eliminating

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[16] *See* Charles River Associates, *Report on Gainful Employment, Executive Summary* prepared by Jonathan Guryan, Ph.D. and Matthew Thompson, Ph.D. (March 29, 2010); and the accompanying Memorandum on the Gainful Employment Rule by Robert Shapiro (Feb. 21, 2011), at 3-4.

[17] Office of Management and Budget, Federal Credit Supplement, Budget of the U.S. Government, FY2012, Table 5 (Direct Loans: Assumptions Underlying the 2012 Subsidy Estimates).

[18] *See* Robert J. Shapiro and Nam D. Pham, Taxpayers' Costs to Support Higher Education: A Comparison of Public, Private Not-for-Profit, and Private For-Profit Institutions, at 46. The study was paid for by Kaplan; the analysis was solely that of the authors.

[19] *See also* the accompanying Memorandum on the Gainful Employment Rule by Robert Shapiro (Feb. 21, 2011), at 5-6.

those students who face the greatest obstacles would be a sound policy. But if the President's priority is to increase substantially the number of college graduates, such a policy is self-defeating.

3. The Gainful Employment Rule Creates Uncertainty

One of the goals of Executive Order 12866 is to "minimize[e] the potential for uncertainty" in regulations. § 1(b)(12). The proposed rule would create uncertainty by subjecting proprietary institutions to sanctions based on economic conditions over which they have no control—and in some instances on the basis of economic data to which they do not have access. Schools cannot predict the job market at the time their students graduate, nor can they predict the repayment rates of the students who graduate or quit. Yet they must predict these things if they are to assure the continued eligibility for Title IV funding upon which their existence depends.

The problem is compounded when the institution attempts to comply with the debt-to-income level requirements of the gainful employment rule. Proprietary institutions do not have access to the repayment records of their students or to the student income data that the Department intends to use to determine debt-to-income levels—data from the Social Security Administration that is not available to the public. Nor do they have the ability to challenge the accuracy of that information. As a result, it would be impossible for proprietary institutions to assess whether their programs are in compliance with the gainful employment rule, much less to ensure in advance that they will be in compliance.

4. There Are Less Burdensome and More Effective Alternatives

There are better ways to further the President's goal of substantially increasing the number of college graduates, while simultaneously protecting students and the public fisc. Existing regulations contribute to high tuitions and loan obligations, and a few simple steps would reduce tuitions, loan levels and default rates—protecting students and the public fisc alike.

First, encourage all proprietary institutions to do what Kaplan has done—provide a four or five-week trial period during which the student and the institution can decide whether the program in which the student has enrolled is right for her. If the student does not continue in the program after the trial period—either because the student decides not to continue or because the institution decides that the student is unlikely to succeed—there is no charge to the student, no need to borrow Title IV money, and no cost to the government. Kaplan began implementing this "Kaplan Commitment" in November 2010, and its experience has been interesting: two-thirds of those who have left within the initial trial period have done so because Kaplan has determined that they are unlikely to succeed.

This kind of program addresses the issues of student debt and potential defaults in a much more direct way than the gainful employment rule—by filtering out altogether those students who should not be incurring debt in the first place and who are most likely to default if they incur debt. Such a program also addresses directly concerns about the quality of programs and the possibility that students may be misled, or may fail to obtain sufficient information, during the recruiting process. If after experiencing what a program is really like the student feels that she made a mistake by enrolling, she can simply withdraw at any time during the initial period without incurring any debt at all.

Congress or the Department could encourage such programs in a number of ways. The Department could provide that adoption of such a program would be an alternative path to compliance with whatever rule the Department adopts. Alternatively, participating institutions could be exempted from the requirement that proprietary institutions obtain 10 percent of their revenues from non-Title IV sources. 20 U.S.C. § 1094(a)(24). The "90-10" rule is designed to ensure, albeit indirectly, that programs are of sufficient quality to meet student needs—based on the assumption that students' willingness to spend their own money, rather than borrowed money, is some measure of a program's quality. The Kaplan Commitment is a much more direct way to ensure that a program is of sufficient quality to meet student needs.

Second, Congress and the Department should recognize that the 90-10 rule has perverse effects and should repeal it. The effect of the "90-10 rule," stated bluntly, is to encourage all proprietary institutions to set their tuitions at 1.12 times the maximum amount that a student can borrow. If the 90-10 rule were repealed, price competition would be introduced into the proprietary sector and tuitions would fall. Loan levels and default rates would likely decline as well.

Third, the most direct way to limit student debt is to limit the amount of money that a student can borrow for a particular program. There is no reason why a student should be permitted to borrow as much to pay for a culinary program as she can borrow to attend law school—and no reason for an institution to charge as much. Limiting the amount that a student can borrow now for certain programs makes far more sense than requiring the graduates to attain certain income levels sometime in the future. The Secretary should exercise the power to limit the amount of borrowing for particular programs or, at the very least, authorize institutions to limit the amount of money that a student can borrow for one of its programs.

These measures would dramatically reduce student debt and defaults—and cut the cost to taxpayers—without depriving anyone of the opportunity to raise herself up to a higher level of learning and employment. In short, they would promote all of the

President's priorities and better serve the interests of students, taxpayers and proprietary institutions alike.

Finally, Kaplan has prepared a list of Minimal Modifications Needed for the Gainful Employment Rule, which accompanies this Memorandum. These modifications could be made without altering the basic approach of the proposed rule. They would increase the rule's flexibility, minimize uncertainty, and align the rule more closely with the underlying statutory mandate. If the basic structure of the rule remains as proposed, we urge the Office and the Department to consider these minimal modifications.

6. Conclusion

For the reasons stated in this memorandum, among others, the proposed gainful employment rule is contrary to law, to the President's priorities, and to any sound notion of sensible regulation.

May 12, 2011

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[4] The two-year cohort default rate remains in effect for enforcement purposes until the year 2014.

[5] The HEA allows students to defer making payments of principal while pursuing graduate education, during periods of military service, and for up to three years during periods of unemployment or "economic hardship." 20 U.S.C. §§ 1077(a)(2)(C), 1087e(f), 1087dd(c)(2)(A); *see* 34 C.F.R. §§ 674.34, 682.210, 685.204. Under the statute, a borrower is deemed to be in a period of "economic hardship" if, *inter alia*, he "is working full-time and is earning an amount which does not exceed . . . an amount equal to 150 percent of the poverty line applicable to the borrower's family size." 20 U.S.C. § 1085(o). The HEA further provides for forbearance—temporary cessation or reduction of payments or extensions of time for making payments—if, *inter alia*, a borrower has a debt that equals or exceeds 20 percent of income, is serving in a national service program, or is eligible for interest payments to be made for service in the Armed Forces. 20 U.S.C. § 1078(c)(3), 1087dd(e); *see also* 34 C.F.R. §§ 674.33(d), 682.211, 685.205. The HEA also authorizes income-based repayment plans that cap annual payments for students who experience "partial economic hardship" at 15 percent of the amount by which the borrower's adjusted gross income exceeds 150 percent of the poverty line. 20 U.S.C. § 1098e(a)(3). If the interest due on the borrower's loan exceeds that amount, principal payments may be deferred indefinitely. *Id.* § 1098e(b).

students facing financial pressure. The HEA's cohort default rule respects these policies by not counting students in deferral or forbearance programs as being in default. By contrast, the repayment rate test contained in the gainful employment rule undermines these policies by counting students in deferral or forbearance as not repaying their loans.[6]

Congress is well aware of the fact that its deferment and forbearance programs have the effect of lowering participating institutions' cohort default rates. In 2003 a report of the Department's Office of Inspector General analyzed this effect and recommended that borrowers in deferment and forbearance be excluded from the default rate calculation—in practice, the principal effect of the gainful employment rule.[7] Congress did not accept that recommendation—although it did later follow another recommendation in the same OIG report to extend the then two-year period within which defaults are captured.[8]

The gainful employment rule is inconsistent with the HEA in other respects as well. Under the HEA, an institution is ineligible to receive Title IV aid on behalf of a student if its cohort default rate exceeds the statutory limit ***for three successive years***.[9] Under the gainful employment rule, a program can lose its eligibility if it fails to meet the prescribed debt-to-income and repayment measures ***for a single year***. Moreover, under the HEA, the Secretary is authorized to excuse an institution that fails the cohort default rate test upon a finding of "exceptional mitigating circumstances," which exist if (i) two-thirds of the students enrolled on at least a half-time basis are eligible to receive one-half the maximum Pell Grant or have incomes below the poverty level, and (ii) in the case of degree programs, 70 percent of the students completed their programs on time, transferred, remained enrolled or entered military service, or (iii) in the case of

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[6] The inconsistencies between the gainful employment rule and the cohort default provision of the HEA are compounded when one examines in detail how the two treat the issue of economic hardship. The HEA requires the Secretary to consider low incomes and high debt-to-income levels "as primary factors" in granting "economic hardship" deferments, which in turn reduce an institution's cohort default rate and preserve its eligibility. 20 U.S.C. § 1085 (m). By contrast, the gainful employment rule uses low incomes and high debt-to-income levels to render an institution ineligible.

[7] Office of Inspector General, Audit to Determine if Cohort Default Rates Provide Sufficient Information on Defaults in the Title IV Loan Programs, ED-OIG/A03-C0017, at 20-27 (Dec. 2003).

[8] *Id.* at 9-19. *See* Higher Education Opportunity Act of 2008, PL 110-315, 122 Stat. 3295 (Aug. 14, 2008) (extending the period during which defaults are captured from two to three years starting in fiscal year 2012).

[9] The default rate regulations also provide for the loss of Federal Direct Loan Program eligibility based upon a default rate exceeding 40 percent for just one year. 34 C.F.R. §§668.187(a)(1) and 668.206(a). The one-year trigger is not only significantly higher than the three-year trigger; it also does not bar eligibility for all federal student aid programs, as the three-year threshold does and the gainful employment rule would.

non-degree programs, the school had placed 44 percent of the students originally scheduled to complete their program during the year. 20 U.S.C. § 1085(a)(5), The gainful employment rule contains no such provision for avoiding the impact of its repayment and debt-to-income requirements.[10]

The Department has authority to interpret and implement the HEA. But it does not have authority to promulgate a regulation that alters the statutory definition of a "proprietary institution of higher education," that conflicts with the HEA's cohort default provision, and that fails to take account of the deferment and forbearance programs authorized by Congress to modify borrowers' repayment obligations. In all of these respects, the gainful employment rule is "[in]consistent with applicable law." Ex. Order 12866, § 6(b).

2. The Gainful Employment Rule Undermines the President's Priorities

President Obama has set a goal of leading the world in the percentage of college graduates by 2020—the United States now ranks #12.[11] The Department acknowledged that goal—and the importance of the for-profit sector in achieving that goal—when it proposed the gainful employment rule: "[f]or-profit postsecondary education . . . has long played an important role in the nation's system of postsecondary education and training," and "President Obama's goal of leading the world in the percentage of college graduates by 2010 . . . cannot be achieved without a healthy and productive higher education for-profit sector." 75 Fed. Reg. 43617.

At a time when state and local governments—the chief sponsors of community colleges and nonprofit vocational institutions—are facing considerable financial difficulties, proprietary institutions have stepped in to fill the gap, providing educational opportunities for millions of students who otherwise would have been without options. Proprietary institutions play a particularly important role in providing educational opportunities for the segment of the population that needs to be

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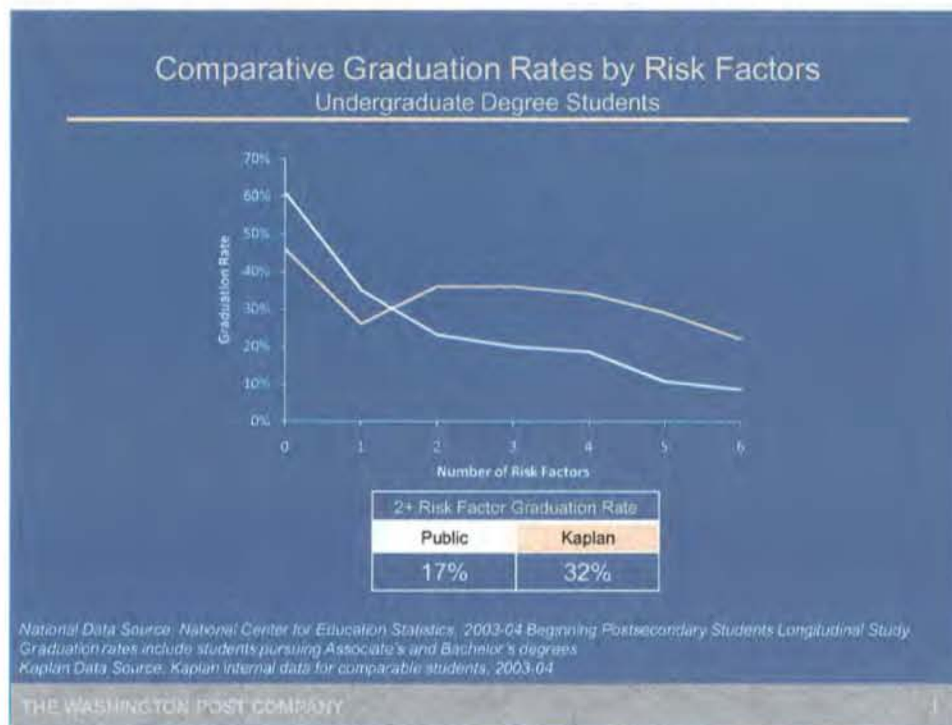
[10] There is still another inconsistency: the debt-to-income test of the gainful employment rule is premised on ***predicted*** default rates, rather than the ***actual*** default rates that the cohort default rate measures. The Notice of Proposed Rulemaking explains that "[d]ebt service rates have a connection to whether borrowers will default on their loans," and that "[b]orrowers with rates above the 8 percent threshold [for full eligibility under the gainful employment rule] have a default rate of 10.2 percent, compared to a rate of 5.4 percent for those below the threshold." "Borrowers with debt rates above the 12 percent threshold [that triggers restrictions or ineligibility]," the Notice continued, "have a default rate of 10.9 percent." 75 Fed. Reg. 43618. In other words, the gainful employment rule renders a program potentially ineligible based on a ***predicted*** or ***expected*** default rate of roughly 10 percent, whereas the cohort default rule renders a program eligible as long as its ***actual*** default rate is below 30 percent.

[11] Organization for Economic Co-Operation and Development, *Education at a Glance 2010*, Table A1.3a, available at http://dx.doi.org/10.1787/888932310092.

brought into the college ranks if the President's goal is to be achieved—non-traditional students who work full time, have dependent children, or whose pursuit of higher education has been delayed by military service, financial difficulties or family circumstances. To illustrate this point: the average Kaplan undergraduate student arrives with four of the seven graduation risk factors that have been identified by the Department of Education, compared to the national average of 1.5.[12]

For-profit schools like Kaplan not only attract a higher percentage of these at-risk students; they do a superior job of graduating them. Below is a graph that compares the graduation rate of undergraduate degree students (Associate's and Bachelor's degrees) at Kaplan with the national average at all colleges and universities (public, non-profit, and for-profit). It shows that among undergraduate students with two or more risk factors—the kind of student that Kaplan serves— Kaplan students graduate at a rate that is almost two times the national average (32 percent at Kaplan versus and a national average of 17 percent).[13]



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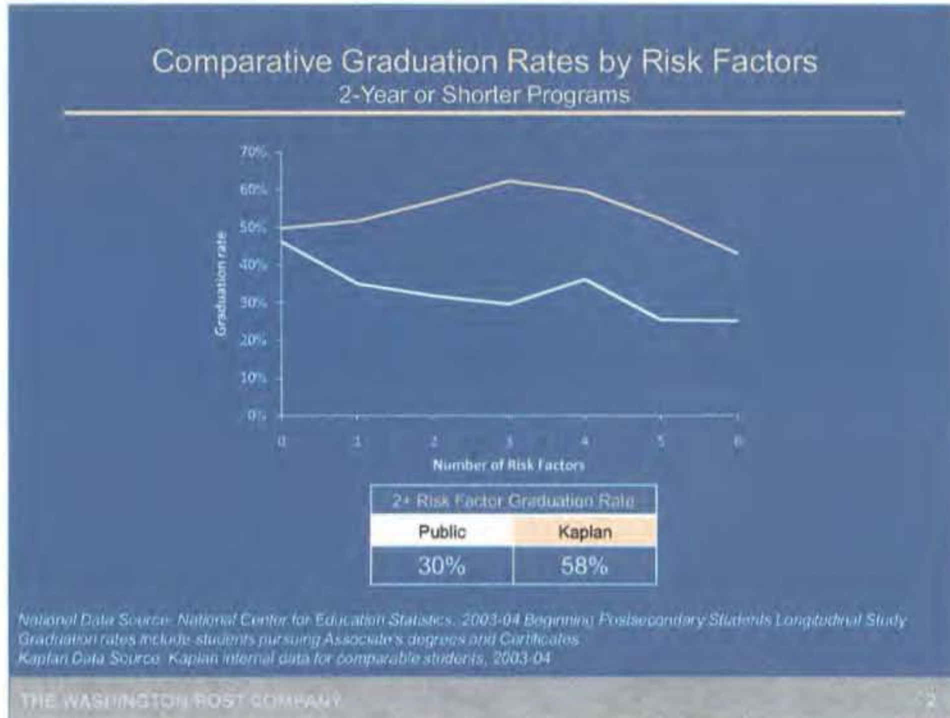
[12] These graduation risk factors are: delayed enrollment (the student is older); full-time work; part-time school attendance; lack of parental support; legal dependents; lack of high school diploma; and single parent status.

[13] The analyses reflected in the two graphs in the text are based on a 2003 student cohort interviewed at years one, three and six after college entry.

The story is the same among students in programs that are two-years or shorter—students pursuing Associate's degrees and certificates. Here again, as the next graph shows,[14] students with two or more risk factors graduate from Kaplan at a rate that is almost two times the national average (58% at Kaplan versus 30% at public institutions).[15]



Not only do proprietary institutions like Kaplan do a better job of graduating high-risk students; they do so at a lower cost to the taxpayer. The Department appears to assume that the cost to the taxpayer is higher at for-profit institutions because the default rate is higher. But there are at least three flaws in that assumption:

First, default rates are higher at for-profit schools because they serve a higher percentage of low-income students, racial and ethnic minorities, and students who are

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[14] We included only public institutions in this comparison because independent non-profit institutions, for the most part, do not offer Associate's degree and certificate programs.

[15] Other studies show the same thing. *See* Robert J. Shapiro and Nam D. Pham, Taxpayers' Costs to Support Higher Education: A Comparison of Public, Private Not-for-Profit, and Private For-Profit Institutions, at 19 (showing substantially higher graduation rates at 2-year and less-than-2-year for-profit institutions); Roger Lytle, Roger Brinner and Chris Ross, *Parthenon Perspectives on Private Sector Post-Secondary Schools* (March 12, 2010), at 13 (showing significantly higher percentage earnings growth among graduates at 2-year and less-than-2-year proprietary schools). Additional data is summarized in the accompanying Memorandum on the Gainful Employment Rule by Robert Shapiro (Feb. 21, 2011), at 4-5.

first in their immediate families to attend post-secondary schooling.[16] (If the gainful employment rule were applied to Historically Black Colleges and Universities, 95 percent would be ineligible under the repayment rate test.)

Second, a dollar of defaulted debt is not a dollar of debt unpaid. OMB assumes that the government will recover $112 for every $100 of defaulted student debt.[17]

Third, and most important of all, defaulted debt is hardly the most significant educational expenditure that taxpayers incur through their federal and state governments. Community colleges and other public colleges and universities are heavily subsidized by the government. Non-profit colleges and universities also receive government grants of various kinds. A recent study prepared by Robert J. Shapiro (Undersecretary of Commerce for Economic Affairs under President Clinton) and Nam D. Pham compared all of the government support, direct and indirect, provided to private sector for-profit colleges, public colleges, and private non-profit colleges. The study concluded that over the course of a four-year program, public colleges receive six-and-a-half times as much money from the taxpayers on a per-pupil basis ($15,540) as private sector (for-profit) institutions do ($2,394). Even private non-profit colleges receive more taxpayer support on a per-pupil basis ($7,065) than for-profit colleges ($2,394)—in fact, almost three times as much. [18]

In sum, for-profit schools do a better job of graduating at-risk students than public and non-profit institutions, at a fraction of the cost to the taxpayer. They also provide capacity that the public and non-profit schools cannot provide. These are the reasons why they are essential to achieving the President's goal of leading the world in the percentage of college graduates.[19] The gainful employment rule undermines this goal by incentivizing the proprietary sector to turn away the very students who are most in need of the opportunities that they provide—the low-income, high-risk students who are statistically most likely to jeopardize the school's continued eligibility to participate in the Title IV program. If the purpose of Title IV were to save the government money, shrinking the ranks of the proprietary institutions by eliminating

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[16] *See* Charles River Associates, *Report on Gainful Employment, Executive Summary* prepared by Jonathan Guryan, Ph.D. and Matthew Thompson, Ph.D. (March 29, 2010); and the accompanying Memorandum on the Gainful Employment Rule by Robert Shapiro (Feb. 21, 2011), at 3-4.

[17] Office of Management and Budget, Federal Credit Supplement, Budget of the U.S. Government, FY2012, Table 5 (Direct Loans: Assumptions Underlying the 2012 Subsidy Estimates).

[18] *See* Robert J. Shapiro and Nam D. Pham, Taxpayers' Costs to Support Higher Education: A Comparison of Public, Private Not-for-Profit, and Private For-Profit Institutions, at 46. The study was paid for by Kaplan; the analysis was solely that of the authors.

[19] *See also* the accompanying Memorandum on the Gainful Employment Rule by Robert Shapiro (Feb. 21, 2011), at 5-6.

those students who face the greatest obstacles would be a sound policy. But if the President's priority is to increase substantially the number of college graduates, such a policy is self-defeating.

3. The Gainful Employment Rule Creates Uncertainty

One of the goals of Executive Order 12866 is to "minimize[e] the potential for uncertainty" in regulations. § 1(b)(12). The proposed rule would create uncertainty by subjecting proprietary institutions to sanctions based on economic conditions over which they have no control—and in some instances on the basis of economic data to which they do not have access. Schools cannot predict the job market at the time their students graduate, nor can they predict the repayment rates of the students who graduate or quit. Yet they must predict these things if they are to assure the continued eligibility for Title IV funding upon which their existence depends.

The problem is compounded when the institution attempts to comply with the debt-to-income level requirements of the gainful employment rule. Proprietary institutions do not have access to the repayment records of their students or to the student income data that the Department intends to use to determine debt-to-income levels—data from the Social Security Administration that is not available to the public. Nor do they have the ability to challenge the accuracy of that information. As a result, it would be impossible for proprietary institutions to assess whether their programs are in compliance with the gainful employment rule, much less to ensure in advance that they will be in compliance.

4. There Are Less Burdensome and More Effective Alternatives

There are better ways to further the President's goal of substantially increasing the number of college graduates, while simultaneously protecting students and the public fisc. Existing regulations contribute to high tuitions and loan obligations, and a few simple steps would reduce tuitions, loan levels and default rates—protecting students and the public fisc alike.

First, encourage all proprietary institutions to do what Kaplan has done—provide a four or five-week trial period during which the student and the institution can decide whether the program in which the student has enrolled is right for her. If the student does not continue in the program after the trial period—either because the student decides not to continue or because the institution decides that the student is unlikely to succeed—there is no charge to the student, no need to borrow Title IV money, and no cost to the government. Kaplan began implementing this "Kaplan Commitment" in November 2010, and its experience has been interesting: two-thirds of those who have left within the initial trial period have done so because Kaplan has determined that they are unlikely to succeed.

This kind of program addresses the issues of student debt and potential defaults in a much more direct way than the gainful employment rule—by filtering out altogether those students who should not be incurring debt in the first place and who are most likely to default if they incur debt. Such a program also addresses directly concerns about the quality of programs and the possibility that students may be misled, or may fail to obtain sufficient information, during the recruiting process. If after experiencing what a program is really like the student feels that she made a mistake by enrolling, she can simply withdraw at any time during the initial period without incurring any debt at all.

Congress or the Department could encourage such programs in a number of ways. The Department could provide that adoption of such a program would be an alternative path to compliance with whatever rule the Department adopts. Alternatively, participating institutions could be exempted from the requirement that proprietary institutions obtain 10 percent of their revenues from non-Title IV sources. 20 U.S.C. § 1094(a)(24). The "90-10" rule is designed to ensure, albeit indirectly, that programs are of sufficient quality to meet student needs—based on the assumption that students' willingness to spend their own money, rather than borrowed money, is some measure of a program's quality. The Kaplan Commitment is a much more direct way to ensure that a program is of sufficient quality to meet student needs.

Second, Congress and the Department should recognize that the 90-10 rule has perverse effects and should repeal it. The effect of the "90-10 rule," stated bluntly, is to encourage all proprietary institutions to set their tuitions at 1.12 times the maximum amount that a student can borrow. If the 90-10 rule were repealed, price competition would be introduced into the proprietary sector and tuitions would fall. Loan levels and default rates would likely decline as well.

Third, the most direct way to limit student debt is to limit the amount of money that a student can borrow for a particular program. There is no reason why a student should be permitted to borrow as much to pay for a culinary program as she can borrow to attend law school—and no reason for an institution to charge as much. Limiting the amount that a student can borrow now for certain programs makes far more sense than requiring the graduates to attain certain income levels sometime in the future. The Secretary should exercise the power to limit the amount of borrowing for particular programs or, at the very least, authorize institutions to limit the amount of money that a student can borrow for one of its programs.

These measures would dramatically reduce student debt and defaults—and cut the cost to taxpayers—without depriving anyone of the opportunity to raise herself up to a higher level of learning and employment. In short, they would promote all of the

President's priorities and better serve the interests of students, taxpayers and proprietary institutions alike.

Finally, Kaplan has prepared a list of Minimal Modifications Needed for the Gainful Employment Rule, which accompanies this Memorandum. These modifications could be made without altering the basic approach of the proposed rule. They would increase the rule's flexibility, minimize uncertainty, and align the rule more closely with the underlying statutory mandate. If the basic structure of the rule remains as proposed, we urge the Office and the Department to consider these minimal modifications.

6. Conclusion

For the reasons stated in this memorandum, among others, the proposed gainful employment rule is contrary to law, to the President's priorities, and to any sound notion of sensible regulation.

May 12, 2011

Minimum Modifications Needed to the Gainful Employment Rule

(Note: All modifications can be made without altering the Department of Education's approach in the initial Proposed Rule)

--Establish Compliance Standards that Encourage Institutions to Serve High-Risk Students

To encourage and incentivize institutions to serve high-risk students, the metrics for institutional success must be adapted to reflect the fact that both the "risk profile" and average income level of an institution's student body vary widely among institutions. If these underlying demographic realities are not incorporated into the metrics, institutions will quickly recognize that the way to comply with one-size-fits-all standards is to avoid serving high-risk students altogether. Compliance standards should encourage institutions to serve high-risk students, not to abandon them.

--Remove Punitive Provisions that Deem Students In Default Even When They Are Meeting Their Obligations Under an Accepted Repayment Program.

Define the term "in repayment" to include all loans for which students are currently in compliance with accepted repayment programs, including consolidation loans, income contingent loans, income sensitive repayment loans, and deferment and forbearance programs, even if those students are not currently making payments of principal.

--Use Publicly-Available Data to Set Compliance Standards, Not Secret Income Data Unavailable to Institutions.

Ensure transparency in repayment rate data by establishing the publicly-available BLS data as the income standard. While BLS data may not be quite as accurate on an individual basis as IRS/SSA data, it is dramatically more transparent, which is critical for the regulation to be deemed reliable.

--Require Compliance Formulas to Reflect the Fact that Different Educational Credentials Have Different Value, and Provide a Two-Year "Opportunity to Cure" Period.

Establish different formulas for non-degree programs and degree programs, so that the debt-to-income thresholds and other variables will better reflect the increases in lifetime earnings that come from progressive educational accomplishments. For instance, data indicate that earnings increase significantly in the "out years" for many professions.

In addition, establish a two-year "cure" period, in which institutions that exceed the 8% or 12% threshold have an opportunity to come back into compliance. Two years are needed because of the time lag between when institutions submit data and when results are reported back. The workable matrix is below:

Program Level	Debt-to-Income Threshold	BLS Percentile	Years in Repayment
Non-Degree	8%	25th	15
Associate's / Bachelor's Degree	12%	50th	15

--Ensure that Institutions Have Two Avenues to Compliance.

The Higher Education Act provides very limited flexibility to institutions that wish to reduce or limit the debt taken on by student borrowers. Allowing institutions to comply either through the "debt-to-income" metric or the repayment rate metric as the compliance standard — rather than being subject to both — is reasonable.

--Ensure an Orderly Phase-in Transition Period.

Extend the phase-in period to three years to provide institutions with the opportunity to adjust to the new requirements, rather than requiring that they be judged based on retroactive data.

Memorandum on the Gainful Employment Rule

Robert Shapiro
February 21, 2011

The Department of Education has proposed a "Gainful Employment Rule" which would restrict the use of federal student loans at private for-profit institutions of higher education if the federal student loan debt burden of an institution's former students exceeds 8 percent of an income level set at 25 percent of median income. I have been asked to analyze this regulation, and I find that it is conceptually flawed in several critical ways.

(1) It does not take proper account of demographic and socio-economic factors which affect income and which vary significantly across institutions of higher education;

(2) It does not recognize political and economic factors which force many students attending for-profit institutions to depend disproportionately on federal loans, compared to those attending public and private not-for-profit institutions;

(3) It ignores the federal government's role in setting the terms of federal student loans, implicitly attributing much of that role to the for-profit institutions.

(4) It does not recognize the singular capacity of private for-profit institutions to expand enrollments in a period of budget constraints and reduced private support.

As a result, the regulation could have the perverse effects of reducing access to higher education by minority and low-income students traditionally underserved by private not-for-profit and public institutions, and undermining President Obama's goal to substantially increase the numbers and share of young people with post-secondary training.

The regulation fails to take account of factors which affect the income of students who have attended private for-profit institutions.

The relationship between a student's loan burden and income after he or she leaves an institution of higher education is complex. The student bodies of different institutions and classes of institution (private for-profit, public, and private not-for-profit institutions) differ in their distribution by gender, race, and household income. In addition, where a young worker lives has direct and indirect effects on his or her income. To evaluate properly the loan burden-to-income relationship for a particular institution, the rule would have to take into account (hold constant) these and other factors that affect a person's income upon leaving higher education. These factors include,

- *Gender:* As women earn less than men for the same occupations and jobs, the rule would have to adjust the income variable for any difference between the gender composition of an institution's former students and the overall population;

- *Race:* As Black Americans and Hispanics earn less than whites for the same occupations and jobs, the rule would have to adjust the income variable for these differences in an institution's student body, compared to the overall population;

- *Family Income:* Young people from low-income families earn less than young people from middle-class or affluent families. As this factor interacts with race, the rule would have to determine this interaction and further adjust the income variable for any independent effect from this factor;

- *Household Composition:* As workers in households with a sole earner earn more than secondary workers in households with multiple earners, the rule would have to adjust the income variable for differences in household composition between an institution's former students and the overall population;

- *Location:* As pay for the same occupation varies by location and region, the rule also would have to adjust the income variable for this factor;

- *Job Market Conditions:* The availability of jobs and the wages at those jobs, especially for new labor force entrants, vary according to the economic conditions of a particular location and region. These conditions will vary over time at each location; and the income variable would also have to adjust for these variations.

The National Center for Education Statistics has found that the student bodies of private for-profit institutions are disproportionately female, minority, from low-income families, and more likely to be married, compared to the student bodies of public and private not-for-profit institutions, and to the population of young workers. For example,

- In 2003, 32.3 percent of students attending four-year private for-profit institutions were Black or Hispanic, compared to 20.4 percent of students at four-year private not-for-profits and 22.3 percent off those at four-year public institutions. The same differences, to a lesser degree, are evident in the student bodies of two-year institutions.

- In 2008, 38.6 percent of students attending four-year private for-profit institutions came from low-income families (incomes of less than $25,000), compared to 22.9 percent of those attending four-year private not-for-profit institutions and 31.1 percent of students at four-year public institutions. Students from low-income families represent comparable shares of students at two-year private for-profit and two-year private not-for-profit institutions – 45.8 percent and 45.5 percent, respectively -- while only 28.4 percent of those attending two-year public institutions come from low-income families. .

A student's income after leaving an institution of higher education also reflects his or her choice of occupation, which may be voluntary or determined by job availability. Such voluntary choices may vary across the demographic and socio-economic factors noted above, compared to the general population, and the involuntary choices almost certainly will vary by location and region. To properly evaluate the relationship between the debt burden of an institution's former students and their income, the income variable also should be adjusted for choices of occupation.

The regulation also does not take account of political and institutional factors which force students at private for-profit institutions to rely disproportionately on federal loans.

The proposed regulation focuses on the burden of loans from the federal government, relative to income, for students who attended private for-profit institutions. It ignores the limited access of those students to other sources of support available to those attending public and private not-for-profit institutions, especially loans and grants from state and local government and private loans and grants supported by the endowments of private not-for-profit institutions and direct government grants to public institutions. Most private for-profit institutions were founded in recent decades, limiting their ability to accumulate resources to provide large direct assistance to their students. The limited access of students at private for-profit institutions to these state, local and institutional sources of support forces them to depend more on support from the federal government. As a result, the default rate on federal loans to students who attended private for-profit institutions, as compared to students from public and private not-for-profit institutions, may not accurately reflect the success of private for-profit institutions of higher education to prepare their students for the American job market.

- In 2008, roughly comparable shares of students received financial assistance of some kind, especially those attending four-year institutions: 76.2 percent of students at private for-profits received some form of assistance, compared to 77.5 percent of those attending public institutions and 86.0 percent of those at private not-for-profits. At two-year institutions, 86.9 percent of those attending private for-profits received some kind of financial assistance, compared to 84.5 percent of students at private not-for-profits and 62.6 percent of those at public institutions. The lower incidence of financial aid for those at two-year public institutions reflects the support that community colleges receive from state and local governments, which enables them to keep tuitions relatively low.

- A much smaller share of students at private for-profit institutions receive assistance from state and local governments. In 2008, 7.2 percent of students at four-year for-profits received grants from state and local governments, compared to 30.0 percent of those attending four-year private not-for-profits and 37.5 percent attending public institutions. At two-year institutions, 10.4 percent of students at private for-profit institutions received state or local government grants, compared to 29.8 percent of those attending private not-for-profits and 33.4 percent attending public institutions.

- In addition, a much smaller share of students at private for-profits receive scholarship grants from their institutions, reflecting in part the absence of large endowments at these younger institutions. In 2008, 20.5 percent of students at four-year for-profits received scholarship grants, compared to 36.3 percent of those attending state-supported public institutions and 75.2 percent of those attending private not-for-profits, many with large private endowments. At two-year institutions, 7.9 percent of those attending private for-profits received grants from those institutions, compared to 35.2 percent of students at private not-for-profits and 10.6 percent of those attending public institutions.

- The low level of student assistance provided by private for-profit institutions to their students also reflects the large differences in the direct assistance which these institutions

receive from federal, state and local governments, through appropriations, contracts and grants to the institutions. In 2008, such direct government support for four-year private for-profits averaged $575 per-enrolled student, compared to $4,765 per-student at private not-for-profits and $13,240 per-student at public institutions. Moreover, after taking account of taxes paid by private for-profits institutions, the net direct government support to those four-year institutions was - $22 per-enrolled student. Across two-year institutions, direct government support averaged $1,084 per-student at private for-profits and $599 per-student net of taxes paid by those institutions. By contrast, two-year private not-for-profit institutions received an average of $2,359 per-student in direct support, and two-year public institutions received an average of $5,233 per-student.

The gainful employment rule has been defended through an analogy with subprime mortgages, implying that private for-profit institutions encourage students to assume federal debt burdens that exceed their capacity once they leave the institution. This analogy is flawed, because it misconstrues the roles of the government and the institutions in setting the terms for these loans, and the government's proper interest in the subprime mortgage meltdown.

- Federal, state and local governments, not educational institutions, are the lenders for student loans and operate student loan programs. These programs encourage young Americans to further their education by providing loans at attractive terms. These terms as set by the government – delayed payment until after a student leaves an institution, subsidized interest rates for these loans, and the absence of collateral requirements – increase the size of the loans that students are prepared to carry and consequently determine the burdens they bear on leaving.

- The subprime analogy is off-point in other ways. The federal government's proper interest in the subprime mortgage meltdown arises from its systemic effects. Every American bears some of the costs of the financial crisis and deep recession triggered by the failures of large numbers of subprime (and conventional) mortgages and the negligent and reckless behavior of large financial institutions. No such broad public policy interest is implicated in the phenomenon of certain numbers of students being unable or unwilling to meet their student loan obligations.

- Since taxpayers bear the costs of defaults on student loans, the government has an appropriate interest in reducing those defaults. However, a student's ability to meet his or her student loan obligations depends not only on income, which is affected by numerous factors unrelated to the education they received (see above); it also depends on the size and terms of the loan. Since those terms are set by government, not educational institution, the appropriate way to reduce defaults would be to change the terms of the loans, as private lenders do to limit defaults, including reducing the size or availability of loans to those deemed most likely to default. This approach, however, would reduce access to higher education, especially for minority, low-income and female students.

Data do not support the implication, also drawn from the subprime analogy, that private for-profit institutions systematically fail to educate their students to succeed in the job market. This implication not only does not take account of the demographic and socio-economic

differences between students who attend private for-profit institutions and those attending private not-for-profit and public institutions, and the impact of those differences on income after leaving school. It also ignores data on the success of students who attend private for-profit institutions, especially minority and low-income students.

- Graduation rates for white, black and Hispanic students who attend four-year private for-profit institutions are slightly lower than the graduation rates at four-year private not-for-profits, and substantially higher than those rates at four-year public institutions. At four-year private for-profits, 50 percent of white students, 45 percent of black students, and 54 percent of Hispanic students graduate, slightly less than the graduation rates of 58 percent, 50 percent and 57 percent, respectively, at private not-for-profits. However, only 46 percent of white students, 38 percent of black students and 43 percent of Hispanic students at four-year public institutions graduate.

- As measured by graduation rates, the relative success of two-year private for-profits, compared to two-year public institutions, is even greater. In 2006, the graduation rate at two-year private for-profits averaged 62 percent for white students, 54 percent for black students, and 63 percent for Hispanic students; by contrast, graduation rates at two-year public institutions were 31 percent for white students, 23 percent for black students, and 30 percent fort Hispanic students.

- At institutions with student bodies that are predominantly lower-income (50 percent or more of total enrollment), graduation rates are consistently higher at private for-profit than other institutions. In 2006, the graduation rates for such four-year institutions were 55 percent for the private for-profits, 39 percent for such four-year private not-for-profits, and 31 percent for such four-year public institutions. At two-year institutions with predominantly lower-income student bodies, graduation rates is 2006 were 56 percent for the private for-profits, compared to 45 percent for such private not-for-profit institutions, and 24 percent for such public institutions.

- Similarly, at institutions with at least 75 percent minority enrollments, the average graduation rate for four-year private for-profit institutions was 47 percent, compared to 40 percent at such four-year private not-for-profit institutions and 33 percent at such four-year public institutions. The relative success at two-year private for-profit institutions with at least 75 percent minority enrollments is even greater – an average graduation rate in 2006 of 56 percent, compared to 44 percent at such two-year private not-for-profit institutions and an average 16 percent graduation rate at such two-year public institutions.

The Gainful Employment Rule, as currently proposed, could substantially hinder President Obama's policy of expanding college enrollments and producing five million additional associates degrees and certificates by 2020.

President Obama has set a new national goal of significantly expanding higher-education enrollments and graduations, so the United States once again will have the world's best educated young population. Meeting these goals will require major expansions in higher-education

facilities and personnel. These goals probably cannot be achieved without private for-profit institutions playing a large role, which the proposed rule could significantly limit.

- The private for-profit sector has shown a singular capacity to expand to meet increased demand for higher education. Since the mid-1990s, that demand has risen sharply, and the number of students attending post-secondary institutions increased 35 percent, from 14.3 million in 1995 to 19.6 million in 2008. Over that period, attendance at private for-profit expanded by 750 percent, from 240,000 to 1,800,000 million students. Enrollments at public institutions increased 27 percent, from 11,092,000 to 14,092,000; and enrollments at private not-for-profits rose 26 percent, from 2,929,000 to 3,685,000.

- Therefore, private for-profits, which accounted for 1.7 percent of all higher-education enrollments in 1995, absorbed 29.4 percent of those increased enrollments. By contrast, public institutions, which accounted for 77.8 percent of all enrollments in 1995, absorbed 56.7 percent of the increase; and private not-for-profits, which accounted for 20.5 percent of enrollments in 1995, absorbed 14.3 percent of the increase.

- The superior ability of private for-profit institutions to expand quickly reflects its sources of financing. These institutions raise capital for their expansion in private markets, which have been ready to provide it. Public institutions depend on funding from the federal, state and local governments for their operations and expansion, and those sources are increasingly limited and likely to be even more constrained in coming years. Similarly, private not-for-profit institutions depend on government resources, endowment income and private contributions to finance their expansions; and all of these sources of funds are increasingly limited by tight federal, state and local government budgets and subnormal economic conditions.

- In addition, private for-profit institutions have aggressively embraced the use of cost-saving technologies, including online learning, which can be scaled up to accommodate increased enrollments. Further, their use of a non-tenure system of faculty employment, including extensive use of part-time faculty, also enables them to quickly and efficiently expand their faculties to serve larger enrollments. While public and private not-for-profit institutions have begun to adopt forms of online learning, they remain significantly behind the private for-profit institutions in this regard. Further, their dependence on a tenure system -- which to be sure has certain benefits -- will continue to limit their capacity to expand enrollments to help meet the President's goals.

- An expanding private for-profit sector of higher education also would reduce the costs of meeting the President's goal to produce an additional five million associate degrees and certificates. These savings reflect the higher graduation rates and much lower direct government support for private for-profit institutions, especially compared to public institutions.

If the Gainful Employment Rule is based on concerns about the capacity of private for-profit institutions to prepare students for success in the U.S. job market, the response should involve accreditation requirements and disclosure of the "success rates" of students at all classes of

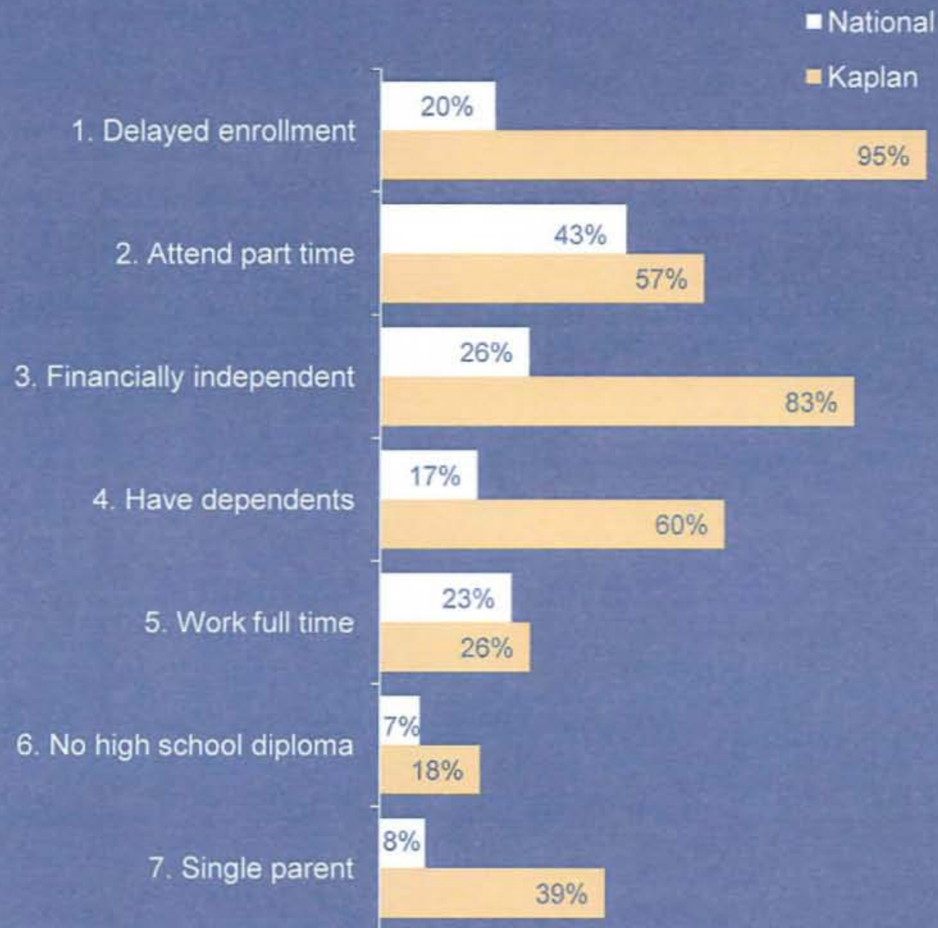
institutions, including graduation rates, securing employment in chosen fields, and average income earned, by occupation.

- In 1992, Congress enacted major reforms of higher education which subjected private for-profit institutions to new regulatory oversight by the Department of Education, state governments and accrediting agencies. These reforms increased the minimum length of programs eligible for federal student assistance, tightened procedures for recruiting and admitting students, required accreditation for eligibility for Title IV funding, and established much stricter standards for such accreditation. By 1996, the General Accounting Office found that the new accreditation requirements had raised the quality of private for-profit institutions and eliminated sub-quality institutions. These improvements linked to the accreditation requirements helped lay the foundation for the vast expansion of enrollments at for-profit institutions seen since 1995.

- Additional disclosure requirements for all private and public institutions should improve the market for higher education. The recent rapid expansion of private for-profit institutions almost certainty reflects such market dynamics: As noted, graduation rates at private for-profits are competitive with graduation rates at private not-for-profits and superior to graduation rates at public institutions. Moreover, these successes are especially notable for minority, low-income and other "at risk" students, which traditionally have had less access to higher education than more affluent and non-minority students.

- The performance and outcome measures sued for accreditation and disclosure should take account of the demographic and socio-economic composition of an institution's student body, described earlier. To accurately assess the quality of the education which at-risk students receive, their results should be evaluated in the context of the hurdles they overcome and not in same terms as students from more privileged backgrounds with far superior prior educations. Without contextualizing the results in this way, these measures would encourage private for-profit institutions to reduce access to higher education for many lower-income and minority students, which also would be the likely result of applying the Gainful Employment Rule as currently conceived.

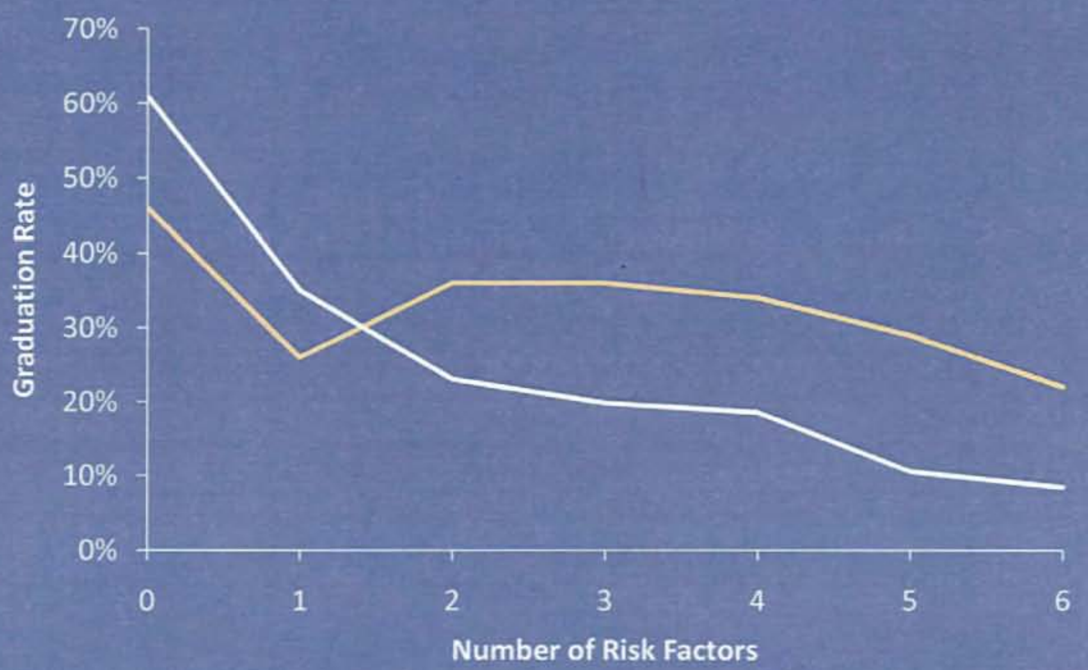
Undergraduates with Risk Factor Traits [1]



[1] Source for National Data: National Center for Education Statistics, 2003-04 Beginning Postsecondary Students Longitudinal Study
Kaplan Data Source: Kaplan internal data

Comparative Graduation Rates by Risk Factors

Undergraduate Degree Students

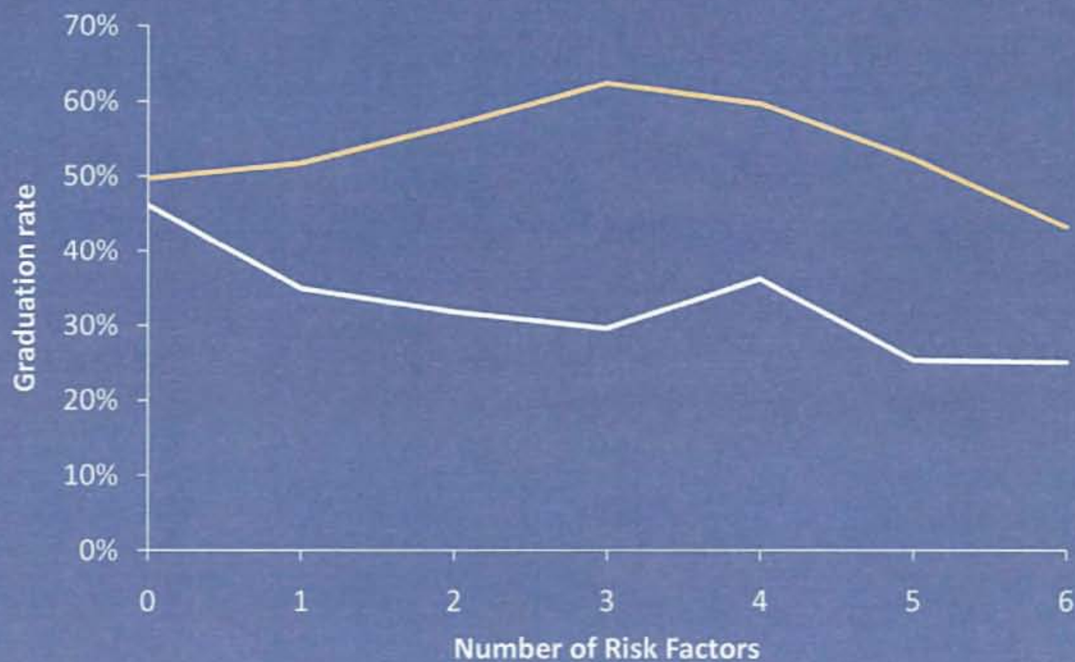


2+ Risk Factor Graduation Rate	
National	Kaplan
17%	32%

National Data Source: National Center for Education Statistics, 2003-04 Beginning Postsecondary Students Longitudinal Study
Graduation rates include students pursuing Associate's and Bachelor's degrees
Kaplan Data Source: Kaplan internal data for comparable students, 2003-04

Comparative Graduation Rates by Risk Factors

2-Year or Shorter Programs



2+ Risk Factor Graduation Rate	
National	Kaplan
30%	58%

National Data Source: National Center for Education Statistics, 2003-04 Beginning Postsecondary Students Longitudinal Study
Graduation rates include students pursuing Associate's degrees and Certificates
Kaplan Data Source: Kaplan internal data for comparable students, 2003-04

Net Annual Taxpayer Cost [1]

[1] Includes: Federal, state, and local government support post tax per enrolled student, including direct and indirect support (which includes Federal grants, subsidies, defaulted Federal loans offset by taxes paid).

Source: The Public Costs of Higher Education: A Comparison of Public, Private Not-for-Profit, And Private For-Profit Institutions. Robert Shapiro and Nam Pham. Sonecon LLC; Kaplan Finance