DEFINING "GAINFUL EMPLOYMENT" AND OTHER REFORMS IN FEDERAL EDUCATIONAL LENDING

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INTRODUCTION

Access to higher education has changed radically from just one generation ago: competition to gain access to colleges and universities has grown much stronger;[1] the cost of education has grown dramatically;[2] the value of most degrees no longer confers the same benefits on today's graduates.[3] These and other factors make it increasingly difficult for students to gain access to higher education, afford that education, and make their education pay off in the long run. As a result, students who are able to attend colleges or universities are, increasingly more often, left with high

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1. *See Getting in Gets Harder*, NEWSWEEK, Jan. 2, 2008, http://www.newsweek.com/2008/01/02/getting-in-gets-harder.html.

2. *See Fast Facts*, NAT'L CENTER FOR EDUC. STAT., http://nces.ed.gov/fastfacts/display.asp?id=76 (last visited Nov. 17, 2011).

3. *See* Greg Ip, *The Declining Value of Your College Degree*, WALL ST. J., July 17, 2008, at D1, *available at* http://online.wsj.com/article/SB121623686919059307.html.

debt loads and dismal job prospects upon graduation.[4] As these changes become more pronounced, many now are questioning the value of higher education as the natural next step after graduating from high school. From the view of some economists, students may be acting rationally when they decide against pursuing higher education, even when those students would otherwise be considered highly qualified for, and would have a high likelihood of success at, the next academic level.[5]

It seems, however, students have largely ignored the economics of obtaining a college- or university-level education. More students than ever before are seeking access to higher education.[6] Whether this steady flow of new students is due to their own irrationality, the need to conform to societal norms, or the moral value of a college or university degree that economists are not able to measure, students continue to attend institutions of higher learning in the hopes that their lives will be better for having done so. Sadly, that proposition has not always proven true. The parents of today's college and university graduates started their working lives, on average, with only a fraction of the amount of debt taken on by their children. Furthermore, the diminished value of a college or university education in the employment market leads many students on to graduate-level programs that further compound the debt problem.

These areas of concern have not gone unnoticed by the federal government. Two significant changes in the laws regarding federal student assistance may transform the educational finance paradigm. The first of these is an effort by Congress to increase the availability of higher education: the College Cost Reduction and Access Act of 2007.[7] One of the cornerstones of this legislation was the creation of "Income-Based Repayment."[8] This law will reduce students' repayment obligations with regard to their federal student loans to less than fifteen percent of their annual adjusted gross income per year, with a maximum repayment term of

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4. *See* Blake Ellis, *College Grads: $24,000 in Debt*, CNNMONEY, Oct. 22, 2010, http://money.cnn.com/2010/10/22/pf/college/student_loan_debt/index.htm.

5. *See Are Too Many Students Going to College?*, CHRON. HIGHER EDUC. (Nov. 8, 2009), http://chronicle.com/article/Are-Too-Many-Students-Going/49039/. *But see* Lisa Barrow & Cecilia Elena Rouse, *Does College Still Pay?*, 2 ECONOMISTS' VOICE 41 (2005).

6. Sara Murray, *Grads Head to College in Record Numbers*, WALL ST. J., Apr. 28, 2010, http://online.wsj.com/article/SB10001424052748703832204575210244203411342.html?mod=e2tw.

7. College Cost Reduction and Access Act of 2007, Pub. L. No. 110-84, 121 Stat. 784 (2007).

8. 20 U.S.C.A. § 1098e (West 2010). The Secretary of Education was given the authority to promulgate this repayment system effective July 1, 2009. Higher Education Opportunity Act of 2008, Pub. L. No. 110-315, § 451(a)(3), 122 Stat. 3078, 3261–62 (codified at 20 U.S.C. § 1087e(d)(1)(E) (West 2011)).

twenty-five years.[9] Essentially, students receiving most kinds of federal student loans will qualify for reduced payments if fifteen percent of their income is not enough to cover a normal payment on a ten-year repayment plan.[10] These repayment options are available to students who take on federal student debt regardless of whether they incurred that debt in an undergraduate or graduate program, or at a public, not-for-profit, or for-profit institution.[11]

It is not hard to see how this basic formula could reduce the debt burden on many students struggling after graduation to find employment or maintain an income high enough to make normal scheduled payments. This, in turn, may influence aspiring students' decisions about whether to accept an educational opportunity in the first place. Students, knowing that they will never be obligated to pay back more than fifteen percent of their income, may be induced to pursue degrees or certificates that carry a low probability of leading to a job with a salary high enough to cover normal payments. Some students may even take this idea to an extreme and take on an unsustainable amount of debt without any intention of ever repaying the principal. For example, a law student may take on more than $150,000 to pay for a juris doctor (J.D.) program, knowing she does not ever want to practice law. In fact, she could get her J.D. and work as a park ranger (assuming she is otherwise qualified), make yearly payments nowhere close to the rate necessary to pay off the accrued interest, and then cancel the entire principal after ten years because she has worked in a qualifying public interest position.[12]

The second legal change, and the primary topic of this paper, is the Department of Education's rule change affecting the availability of federal educational loans to students who attend for-profit institutions of higher education. Under the Higher Education Act of 1965, students may take on federal educational loans if they are attending an "institution of higher education."[13] For an entity other than a public or non-profit organization to qualify as an "institution of higher education," the entity must demonstrate that its programs are "prepar[ing] students for gainful employment in a recognized occupation . . . ."[14] The final rule sets out quantitative

9. 20 U.S.C.A. § 1098e(a)(3)(A)-(B), 1098e(b) (West 2010). In addition, the fifteen percent maximum is reduced to only ten percent and the maximum repayment term is reduced from twenty-five to twenty years for new borrowers in 2014. *Id.* at § 1098e(e).

10. 20 U.S.C.A. § 1098e(b) (West 2010).

11. *See Id.*

12. *See* 20 U.S.C.A § 1087e(m) (West 2010). This provision instructs the Secretary of Education to cancel the remaining principal and interest due after ten years of making payments while the debtor is employed in a qualifying public service position. For a definition of qualifying positions, see § 1087e(m)(3)(B).

13. 20 U.S.C.A. § 1091(a)(1) (West 2010).

14. 20 U.S.C.A. § 1001(b)(1) (West 2010).

guidelines for what constitutes "gainful employment" for purposes of the Act. The rule categorizes institutions based on their students' debt-to-income ratio and educational loan repayment rates. For-profit educational institutions whose students have unfavorable debt-to-income ratios, poor repayment rates, or both, may be subject to more rigorous disclosure requirements in their admissions materials and practices, or they may lose the privilege of accepting tuition revenue from federal educational lenders altogether.[15]

Together these programs illustrate moves by the government to simultaneously increase the availability of a college or university education to aspiring students and punish institutions that seek to exploit the existing student loan regime or leave their graduates without a meaningful way to repay educational debts. Both programs have proponents and critics, but what is certain is that they will have a profound impact on the economics of higher education.

The goal of this paper is to analyze the recent rule change by the Department of Education regarding the definition of "gainful employment." This discussion, however, would be incomplete without a basic explanation of the key changes in federal loan repayment effected by the College Cost Reduction and Access Act of 2007. Therefore, I begin Part II with a breakdown of the Act, particularly those provisions that establish Income-Based Repayment and the new incentives students realize as a result of its establishment. I continue in the same section to explain the final rule of the Department of Education. In Part III, I address the criticisms and critiques of the new rule and attempt to predict the rule's real-world impact.

I. THE NEW STUDENT LENDING LEGAL FRAMEWORK

This paper's purpose is to explore the Department of Education's definition of "gainful employment" for purposes of determining an institution's ability to receive revenue from federal student loans. The rule's primary purpose is to restrict the ability of for-profit colleges and universities to produce graduates with heavy debt burdens and no meaningful way to repay their student loans. I dedicate most of this paper to analyzing that rule. I begin, however, with an explanation of the other recent changes in the law that have significantly affected the way students finance their degrees. These changes served as a catalyst for the government's rulemaking, as the Department of Education feared the new laws would further exacerbate the problems associated with students who attend for-profit colleges and universities.

A. The College Cost Reduction and Access Act of 2007 and Income-

15. *See infra* Part II.B.

Based Repayment

Income-based repayment (“IBR”) was passed into law as part of the College Cost Reduction and Access Act of 2007.[16] It provides a mathematical formula to determine the maximum amount students must pay on their federal loans every year. As of July 1, 2009, a qualifying student may claim a “partial financial hardship” if his annual loan payment on a ten-year repayment plan is greater than fifteen percent of his gross adjusted income[17] less 150 percent of his family’s poverty level.[18] Stated differently, a student may claim a partial financial hardship if his annual repayment amount is greater than fifteen percent of his income after subtracting one and one-half times the poverty line. If the student qualifies for partial financial hardship, he is obligated to pay only fifteen percent of his adjusted gross income[19] less 150 percent of his family’s poverty level.[20]

For example, if a single individual with no dependents makes $40,000 in 2011 while repaying his loan, the maximum mandatory payment under IBR would be $3,549.75 a year, or $295.81 a month.[21] The amount is automatically adjusted for income annually, or upon the request of the student after a significant change in income.[22] In addition, the government will pay the interest on certain subsidized federal loans for up to three years if the payment due under IBR does not cover the accrued interest, essentially eliminating the possibility that the principal balance will grow during the first three years of repayment on these types of loans.[23] On other loans, and all loans after three years, any interest not covered by the IBR-adjusted payment will be added to the principal.[24] Thus, while IBR can reduce payments, its use may result in the student paying more overall. For example, if a student is on IBR for an extended period of time early in his repayment and later experiences an increase in income such that he no longer qualifies for IBR, that student could face a much larger repayment burden due to having a larger principal than he would have had if he followed a standard repayment plan. For new borrowers in 2014 and after, the fifteen percent figure referenced above will be reduced to ten percent.[25]

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16. College Cost Reduction and Access Act of 2007, Pub. L. No. 110-84, 121 Stat. 784 (2007).

17. 34 C.F.R. § 682.215(a)(4)(i) (2010).

18. 42 U.S.C.A. § 9902(2) (West 1998); 20 U.S.C.A. § 1098e(a)(3) (West 2010).

19. 20 U.S.C.A. § 1098e(b)(1) (West 2010).

20. Stated formulaically: (.15(I-(1.5*P)))/12=M, where I = adjusted gross income, P = family adjusted poverty level, and M = monthly payment.

21. (.15*(40,000-(1.5*10890))).

22. 34 C.F.R. § 682.215(e)(1) (2010).

23. 20 U.S.C.A. § 1098e(b)(3)(A) (West 2010).

24. *Id.* at § 1098e(b)(3)(B).

25. *Id.* at § 1098e(e)(1).

The Act also includes provisions for debt cancellation. If the student is employed in a qualifying public service position and makes payments under IBR or any other repayment program for ten years, the government will cancel the entire remaining principal and interest.[26] Similarly, students not employed in public interest positions may have their principal and interest cancelled after twenty-five years of payments under IBR.[27] For new borrowers in 2014 and after, the twenty-five-year term is reduced to twenty.[28] IBR is generally available to all federal student loans taken out by the student.[29] It is not available for Federal Parent PLUS loans taken out by the student's parents or guardians.[30] As long as the student-debtor would otherwise qualify for federal educational assistance, the IBR program does not discriminate against any particular institution, degree, or academic program. Thus, the only real limitation to a student's ability to borrow is credit history[31] and the maximums for each loan type where they exist.[32]

The need for the College Cost Reduction and Access Act and IBR came from the inadequacy of the available repayment options. There were four basic types of repayment plans available to student-debtors prior to the passage of the Act: (1) a fixed ten-year repayment plan, (2) a graduated ten-year repayment plan with lower payments at the beginning of the term, (3) an income-sensitive payment plan where the minimum payment would not be less than the interest payment on a ten-year plan, and (4) what has been described as Income Contingent Repayment (ICR).[33] ICR is the closest program to IBR, although it differs from IBR in many significant ways. First, ICR had no public service loan forgiveness.[34] Debt was

26. 20 U.S.C.A. § 1087e(m) (West 2010).

27. 20 U.S.C.A. § 1098e(b)(7) (West 2010).

28. *Id.* at § 1098e(e)(2).

29. *See* 34 C.F.R. § 685.221(a)(2) (2010).

30. *Id.*

31. 34 C.F.R. § 685.200 (2010). The Department of Education uses an easy-to-meet standard. As long as students have no current accounts in default, they should easily qualify. Once a student qualifies, he or she is offered the same interest rates as all other qualifying students. However, some federal loans, such as the Subsidized Stafford, are available only to students who demonstrate a financial need on their FAFSA filing. *See id.*

32. 34 C.F.R. § 685.203 (2010). Graduate students, who tend to take on much more debt than undergraduates, may take out a maximum Stafford amount (both subsidized and unsubsidized) of $138,500 (considering undergraduate and graduate school), with the maximum subsidized amount being $65,000. The annual maximum for graduate students is the cost of attendance less other financial aids, and there is no aggregate maximum.

33. 20 U.S.C.A. § 1087e(b)(9)(A) (West 2010).

34. Philip Schrag, *Federal Student Loan Repayment Assistance for Public Interest Lawyers and Other Employees of Governments and Nonprofit Organizations*, 36 HOFSTRA L. REV. 27, 32-33 (2007).

cancelled after twenty-five years of payments for any borrower.[35] Second, ICR did not reach the same types of debt as does IBR. Prior to 2006, the Federal Direct Loan program, which included the Grad PLUS Loans, did not exist. Therefore, the largest and often only lending that came from the federal government was in the form of Stafford loans.[36] All other educational funding for graduate students had to be found in the private debt market, and private loans were not eligible for ICR.[37] Thus, a substantial portion of student debt did not qualify for any income-sensitive repayment plan.[38] The amount paid on private student loans, moreover, was not a factor in determining a student's payment ability under ICR.[39] Finally, ICR provided that payments would be capped at twenty percent of discretionary income and unpaid interest would be capitalized so that the principal could grow up to 110 percent of the original amount.[40]

Tuition rates for both graduate and undergraduate programs continued to increase in the several decades before IBR became available.[41] This resulted in some students financing more of their education with private loans, as they had exhausted their federal loan eligibility.[42] As a result, many students who may have been inclined to seek low-paying public service jobs were not able to "afford" that career choice.[43] Other students, once confronted with the reality of holding on to their student loans for twenty-five years (the waiting period before their loans would be forgiven) made the decision to abandon public service jobs and seek more lucrative employment in the private sector.[44] This flight from public service appears to be one of the primary motivators for Congress to reform the educational lending process.[45]

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35. *Id.*

36. Stafford loans come in two varieties, subsidized and unsubsidized. Both have traditionally offered comparatively low interest rates, although the rates occasionally change. The unsubsidized Stafford loan, like most loans, begins to accrue interest from the time of disbursement. For the subsidized Stafford loan, the government will pay the interest charges while the student is still in school. 20 U.S.C.A. § 1078 (West 2011).

37. Schrag, *supra* note 34, at 32-33.

38. *Id.*

39. *Id*.

40. 34 C.F.R. § 685.209 (2008).

41. *See* COLLEGE BOARD, http://trends.collegeboard.org/college_pricing/report_findings/indicator/Tuition_Fees_Over_Time (last visited Nov. 17, 2011).

42. Schrag, *supra* note 34, at 29.

43. *Id.*

44. *Id.* (providing anecdotal evidence of graduates who would otherwise have stayed in their public service positions had it not been for their debt burden).

45. H.R. REP. NO.110-210, at 44 (2007). The report states:

> The Committee believes that loan limits should only be raised in tandem with options for students to manage their debt. With students borrowing

Although the bill passed the House 273-149 and the Senate 78-18, there were certainly those who thought the bill's costs outweighed its benefits. For example, Congressman Souder of Indiana worried about the moral hazard caused by the shift in risk-bearing and accountability:

> An income-based repayment program would eliminate once and for all any need for students to weigh their choice of college or university against which type of career they plan to enter after the degree. It's a disconnect with capitalism because you don't have to say, if I get this number of degrees and go this far, how is my job going to repay this? Should I go to a local campus? Should I go to a lower priced college? It's disconnected now based from your choice of employment. While the government surely has a role in increasing access to education, this program would totally strip any incoming college student from making a responsible choice. It's kind-hearted but reckless.[46]

In short, the moral hazard identified by Souder was that a student would pursue "riskier" degrees—those degrees with a small chance of resulting in a job capable of servicing the student's incurred debt—or that the student would pursue a degree with no expectation whatsoever of ever being able to fully pay back his debt.

The program is expected to come at a substantial price. The Congressional Budget Office (CBO) estimates that between 2008 and 2017 the income-based repayment program will cost $1.8 billion.[47] In addition, the CBO estimates that the total amount of loan forgiveness over the same period will be $2.6 billion, and that all the provisions of the Act affecting borrowers together will cost taxpayers $16.3 billion.[48] It is not clear if the

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> at record levels, ensuring borrower protections and alternative payment options is important. According to the Project on Student Debt, ''over the past decade, debt levels for graduating seniors with student loans more than doubled from $9,250 to $19,200—a 108% increase (58% after accounting for inflation).'' H.R. 2669 builds on the existing Income Contingent Repayment Program offered in the Direct Loan program. . . . The Income-Based Repayment proposal guarantees that borrowers will not have to pay more than fifteen percent of their discretionary income in loan repayments, and allows borrowers to have their loans forgiven after twenty years of payments. Payment options such as the Income-Based Repayment proposal serve to expand rather than restrict educational and economic opportunities for graduates who would otherwise be unable to afford to work as teachers or social workers. *Id*. (quoting *Quick Facts About Student Debt*, Project on Student Debt, available at http://projectonstudentdebt.org/files/File/Debt_Facts_and_Sources.pdf).

46. 153 CONG. REC. H7,538-39 (daily ed. July 11, 2007) (statement of Rep. Souder).

47. H.R. REP. NO. 110-210, at 70-71 (2007).

48. *Id.* at 67.

CBO study considered the moral hazard effect when coming to these estimates.

While the Act undoubtedly encourages students who otherwise would not be able to afford higher education to apply for admission to colleges and universities and incentivizes some students to pursue public interest careers, it also incentivizes additional financial risk-taking. This is best explained by example. Take student X, who is considering attending law school. Assume that X's priorities are first practicing law, and second maximizing income. Assume also that X receives no moral satisfaction from a public interest position; he will choose a position strictly on compensation considerations. To pay for law school and its associated costs, X expects to borrow $150,000.[49] Assume that X acts rationally in maximizing first his Federal Subsidized Stafford loans, second his Federal Unsubsidized Stafford loans, and financing the remainder with Federal Direct Grad Plus loans.[50]

For the sake of simplicity, assume there are three career options for law students. C_1 is a private sector job paying $145,000 per year. C_2 is a ten-year debt-cancelation-eligible public interest job that pays $50,000 per year. C_3 is a private sector job paying $50,000 per year. Table 1 shows X's standard (ten-year) loan repayment schedule. Table 2 shows the actual repayment information if X elects to use IBR.

TABLE 1 - LOAN SCHEDULE

	SUBSIDIZED STAFFORD	UNSUBSIDIZED STAFFORD	GRAD PLUS	**TOTAL**
PRINCIPAL	$25,500.00	$36,000.00	$88,500.00	$150,000.00

49. In order to simplify the results, I will treat these loans as beginning to accrue interest when repayment begins. In reality, the Unsubsidized Stafford and Grad PLUS loans will accrue interest beginning on the day of disbursement, usually the first day of a semester.

50. X will owe $25,500 under Subsidized Stafford at 6.8%, $36,000 under Unsubsidized Stafford at 6.8%, and $88,500 under Direct Grad PLUS at 7.9%. The Direct Grad PLUS loan is a loan available only to students enrolled in a graduate degree program. Typically, a graduate student would use the PLUS loan to bridge the gap between the amount received in other forms of financial aid and the student's expected expenses. The maximum a graduate student can borrow is the institution's "cost of attendance," which is a figure determined by the institution as an estimate of what enrolling in a particular program will cost the student.

RATE[51]	6.80%	6.80%	7.90%	
ANNUAL STANDARD PAYMENT	$3,501.62	$4,943.46	$12,745.04	$21,190.11

TABLE 2 - PAYMENT INFORMATION UNDER IBR			
	C1	C2	C3
STANDARD REPAYMENT	$21,190.11	$21,190.11	$21,190.11
IBR MINIMUM PAYMENT	$19,313.25	$5,063.25	$5,063.25
YEARS OF PAYMENTS	11.52	10.00	25.00
TOTAL PAYMENTS	$222,521.59	$50,632.50	$126,581.25
CANCELED AMOUNT	$-	$123,434.52	$302,756.25
INTEREST SUBSIDIZED DURING REPAYMENT	$-	$2,619.74	$2,619.74

If X is able to work at C_1, he may still qualify for IBR even though he is earning a substantial income because his minimum payment under IBR is less than it would be under the standard repayment plan. However, his payments are not significantly different from the standard repayment plan, and under IBR, X's loans must be fully paid off within eleven and one-half years of entering repayment.[52] Given X's high income, X may wish to make larger payments to avoid paying interest and to shed his debt as quickly as possible; there is, however, no requirement that he do this. Because X's income covers his interest payments on the Subsidized Stafford, no additional subsidies are provided on unpaid interest. Additionally, because X's IBR payment schedule is completed well before the twenty-five-year cancelation date, no amount of X's loan will be canceled.

If X is not hired at a C_1 position but is able to obtain the public interest position C_2, the IBR payment is significantly reduced. If X makes IBR payments for ten years while holding this position, the remaining loan

51. The interest rates for these types of loans are fixed at the rates represented above. For undergraduate students, the interest rates for Stafford loans changes year to year. Undergraduate students are not eligible for Grad PLUS loans. *See* DEPARTMENT OF EDUCATION, http://www.direct.ed.gov/calc.html (last visited Nov. 15, 2011).

52. The repayment period is longer than the standard repayment plan because under IBR the principal balance is paid down more slowly, which results in additional accrued interest, which in turn leads to a greater loan balance being serviced with comparatively smaller payments.

amount will be canceled. Furthermore, a portion of the accrued interest is subsidized during the first three years of repayment, as the IBR payment does not cover all of the interest payment on the Subsidized Stafford loan. While it is possible that X would make larger payments and attempt to get out of debt faster than required, this is unlikely, as it might come at a severely reduced standard of living. It is much more likely that X would make the minimum IBR payments and cancel the remaining debt after ten years.

If all else fails and X takes C_3, X's IBR payments will not cover the interest. Therefore, X's payments will be equal to those at C_2, but X will not have the option of canceling the debt after ten years. Rather, X must wait until the twenty-five-year statutory period is complete before the Department of Education cancels the remaining amount.[53] Because X's payments have not covered the interest, taxpayers will bear the entire principal and interest remaining, $302,756.25. It is also noteworthy that X's total payments over twenty-five years would not be enough to cover the initial principal.

Overall, both IBR and the Direct Loan programs have fundamentally transformed the ways in which college and university students (especially graduate and professional students) finance their education. Prior to their enactment, students would decide whether to take out an educational loan just as they would any other loan: by looking at their overall ability to repay the loan in full. Now, the worst-case scenario facing students is that they pay less than fifteen percent of their income per year over an extended period of time. If he wishes, a student may choose to ignore with impunity the question of whether or not he will ever be able to repay the loan principal and interest.

Students pursuing an undergraduate degree are limited by the statutory maximums for their specific degree type;[54] graduate students, however, are limited only by the institutionally determined cost of attendance.[55] In either case, credit from the federal government for educational loans has become easier to access, and the requirement that the loan be repaid in a timely manner has been relaxed. More important, however, is that the new incentive structure of the loans dissociates students' expectation of repayment from the actual amount owed.

Students who attend for-profit colleges and universities may access most of the same federal loans as those who attend private not-for-profit or public colleges and universities. The for-profit institutions are uniquely

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53. Previously, the amount canceled would be considered income to the student for taxation purposes. Now, however, the IRC provides that amount canceled pursuant to the public service provisions is not included in income. 26 U.S.C.A § 108(f) (West 2011).

54. 34 C.F.R. § 685.203 (2009).

55. *See supra* note 34 and accompanying text.

positioned to exploit the safety-net features of IBR and Direct Loans. Through marketing, admissions and financial aid counseling, these institutions may persuade students to attend by pointing out that their repayment requirements may not correlate with the amount borrowed. In 2010, the Department of Education indentified misuse of the incentives in IBR as one of the key reasons why restricting access to federal lending became a regulatory priority.[56]

B.New Definition of "Gainful Employment"

Under the Higher Education Act of 1965, students are eligible to take out most kinds of federal education loans if they are attending an "institution of higher education."[57] To qualify as an "institution of higher education," an entity other than a public or non-profit organization must demonstrate that its programs are "prepar[ing] students for gainful employment in a recognized occupation . . . ."[58] These for-profit institutions have never faced a requirement that they substantiate what those "gainful employment" opportunities might be.[59] The college or university, quite literally, was required only to check a box on a form certifying their program(s) would lead to gainful employment.[60] Thus, the gainful employment standard was anything that the for-profit college or university said it was.

Concern over for-profit programs has gained momentum for several reasons. First, there is concern that admissions and financial aid officers at for-profit colleges and universities engage in exaggeration, misrepresentation, and fraud when enrolling students and preparing their financial assistance materials.[61] Second, as profit-driven entities, for-profit institutions have an incentive to charge students more than would a

56. Program Integrity: Gainful Employment [hereinafter Rulemaking], 75 Fed. Reg. 43616, 43622 (July 26, 2010) (notice of proposed rulemaking) (to be codified at 34 C.F.R. pt. 668).

57. 20 U.S.C.A. § 1091(a)(1) (West 2010).

58. 20 U.S.C.A. § 1001(b)(1) (West 2010).

59. Rulemaking, *supra* note 56, at 43618.

60. *See, e.g*, Application for Approval to Participate in Federal Student Financial Aid Programs, DEP'T OF EDUC., http://www.eligcert.ed.gov/ows-doc/eapp.pdf (last visited Nov. 17, 2011).

61. MAMIE LYNCH ET AL., EDUC. TRUST, SUBPRIME OPPORTUNITY: THE UNFULFILLED PROMISE OF FOR-PROFIT COLLEGES AND UNIVERSITIES 1 (2010), *available at* http://www.edtrust.org/sites/edtrust.org/files/publications/files/Subprime_report.pdf. *See also* U.S. GOV'T ACCOUNTABILITY OFFICE, For-Profit Colleges: Undercover Testing Finds Colleges Encouraged Fraud and Engaged in Deceptive and Questionable Marketing Practices, http://www.gao.gov/products/GAO-10-948T (last visited Nov. 17, 2011) (embedded video).

traditional non-profit or public college or university.[62] In the 2008-09 academic year, for-profit institutions received more than $20 billion in revenue from federal student loans, which accounted for sixty-six percent of total revenue for the industry.[63] Indeed, some for-profit colleges and universities rank among the most profitable companies in the world. From 2005 to 2009, ITT Technical Institute was about ten percent more profitable than Apple and Proctor and Gamble, and about twenty percent more profitable than Home Depot and Lockheed Martin.[64] The average student debt for graduates of for-profit institutions in 2007-08 was $31,190, compared to $7,960 at public institutions and $17,040 at private non-profit institutions.[65] In addition, news outlets frequently report that for-profit college and university graduates are unable to obtain employment in their area of study.[66] The programs of the College Cost Reduction and Access Act of 2007 could potentially exacerbate these circumstances. Admissions officers and marketing representatives could push IBR as an option that would make any of their programs "affordable," thus conditioning students to engage in the risky borrowing activities described in sub-part A of this section. The government affirmatively stated its preference against this sort of behavior: "While the Federal Government is providing new options for repaying loans over extended periods of time to protect a portion of the borrower population from the adverse impact of nonpayment, these repayment options should not be the norm."[67]

Since 2008, the only restriction on for-profit post-secondary institutions has been the so-called "90/10" rule, which requires any for-profit college or university to derive at least ten percent of its revenue from sources other than federal student assistance.[68] This rule has failed to correct the

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62. LYNCH, *supra* note 63. Assuming that cost functions are relatively similar across public, not-for-profit, and for-profit institutions, all three types of institutions have an incentive to collect revenues above cost and use the funds for improvements and expansion; it is only for-profits, however, that have an incentive to provide a return for their shareholders.

63. *Id.* at 2.

64. STEVEN EISMAN, FOR-PROFIT EDUCATION: SUBPRIME GOES TO COLLEGE 13 (2010), *available at* http://www.marketfolly.com/2010/05/steve-eisman-frontpoint-partners-ira.html (last visited Nov. 17, 2011).

65. LYNCH, *supra* note 63, at 6.

66. *See* Nanette Asimov, *More Debts Than Diplomas From For-Profit Colleges*, S.F. CHRON., Dec. 1, 2010, at A1, *available at* http://articles.sfgate.com/2010-12-01/news/25001273_1_nonprofit-colleges-and-universities-report-everest-college. *See also For-profit National College of Kentucky subject of lawsuit*, UPI.COM, Sept. 28, 2011, http://www.upi.com/Top_News/US/2011/09/28/for-profit-National-College-of-Kentucky-subject-of-lawsuit/UPI-23941317224859.

67. Rulemaking, *supra* note 56, at 43621.

68. Non-Title IV Revenue (90/10), 34 C.F.R. § 668.28 (2011); Program Participation Agreement, 34 C.F.R. § 668.14(b)(16) (2011).

problems facing students; as a result, the Department of Education (Department) has begun taking action to substantially regulate the industry. The Department responded by proposing a rule in 2010 that defines "gainful employment" and subjects the integrity of all for-profit programs to a high level of scrutiny.[69] Beginning July 1, 2012, the Department will administer a two-pronged test to determine the viability of a particular program.[70] The first prong is a debt-to-income test. Under this test, programs whose graduates' median annual debt payments do not exceed twelve percent of annual earnings or thirty percent of discretionary income are considered eligible institutions. Those who do not achieve either criterion are considered to have failed this prong of the test.[71] The second prong is a repayment rate test. If the average debt repayment rate of graduates is thirty-five percent or better, the institution will remain eligible for federal assistance; if the repayment rate is below that percentage, the institution is considered to have failed that prong.[72] For both prongs, the students considered in calculations are, in most circumstances, those in their third and forth years of repayment, a class referred to as the "two-year period test" (2YP).[73] Using this metric rather than students' first years in repayment is thought to provide a better picture of students' prospects for long-term success and financial stability.

There are also several alternative student classes used for calculation purposes designed to accommodate those programs whose graduates experience an abnormal income growth pattern. In the first formulation of the 2YP test, the earnings information is determined by taking the median income of former students in the third and fourth years after entering repayment.[74] During the negotiated rulemaking process, however, it was brought to light that some programs' graduates experienced several years

69. Rulemaking, *supra* note 56, at 43616; Program Integrity: Gainful Employment – New Programs, 75 Fed. Reg. 66665 (Oct. 29, 2010) (final rule) (to be codified at 34 C.F.R. pt. 600).

70. While the regulations take effect in 2012, the Department determined in its final promulgation of the rule that it would allow institutions subject to the regulations a three-year grace period to enter into compliance. Program Integrity: Gainful Employment—Debt Measures, 76 Fed. Reg. 34386, 34389 (June 13, 2011) (to be codified at 34 C.F.R. pt. 668). For instruction on what constitutes a "program" for the rule's purposes, *see id.* at 34400; *see also* DEPARTMENT OF EDUCATION, Gainful Employment Electronic Announcement #11 - Determining Whether an Educational Program is a Gainful Employment Program (June 24, 2011), http://ifap.ed.gov/eannouncements/062411WhatisGainfulEmploymentGEAnnounceNumber11.html.

71. Program Integrity: Gainful Employment—Debt Measures, 76 Fed. Reg. 34386, 34449 (June 13, 2011) (to be codified at 34 C.F.R. pt. 668).

72. *Id.*

73. *Id.*

74. *Id.*

of low income commonly followed by a relative spike, most often seen in medical and dental programs.[75] To account for these programs, several alternative classes were developed. For example, a "four year period" (4YP-R) class was developed. It tests the sixth, seventh, eighth, and ninth fiscal years after the student enters repayment if the student is in a qualifying medical or dental residency program.[76] By developing alternative classes from which to test income and debt data, the Department attempted to find the best indicators of the long-term financial health of a particular program's participants. Table 3 shows the preceding information in tabular form:

TABLE 3 - QUANTITATIVE TEST OF PROGRAM INTEGRITY			
MEASURE	DEBT-TO-INCOME		
		Debt payment is below 12% of annual earnings or below 30% of discretionary income.	Debt payment is above 12% of annual earnings and above 30% of discretionary income.
REPAYMENT RATE	Above 35%	*Eligible*	*Eligible*
	Below 35%	*Failed Program*	*Eligible*

If a program fails both the repayment rate test and the debt-to-income test, the program is subject to progressively more burdensome restrictions the longer they continue to fail. Programs in their first year of failure are required to provide all of their current and prospective students with a debt warning consisting of the results of the two tests.[77] Programs in their second year of failure and programs that have failed two out of three consecutive years must, in addition to providing the debt warning, provide an explanation of what remedial steps the program plans to take, an explanation of the risk associated with continuing in the program, and an explanation of the difficulty the student is likely to have repaying his

75. Rulemaking, *supra* note 58, at 43620. Some programs are customarily followed by lengthy internships or apprenticeships for which the pay is low, but those internships are typically followed by employment that is capable of sustaining debt payments. For example, medical students go through several years of residency during which their pay is relatively low, but once the residency period is over the graduates typically experience a large spike in income.

76. Program Integrity: Gainful Employment—Debt Measures, 76 Fed. Reg. at 34, 449 (June 13, 2011) (to be codified at 34 C.F.R. pt. 668).

77. *Id*. at 34, 452.

debt.[78] If a program fails both tests for three of the four previous years, that program is considered an ineligible program, meaning that students enrolled in such a program are no longer eligible to borrow most federal student loans.[79] Because a vast majority of for-profit colleges and universities derive revenue from federal student loans, a program's ineligibility may well make its continued existence next to impossible.

One of the obstacles to creating the rule was determining what should and should not count as repayment sufficient to count toward an institution's "repayment rate." The problem is particularly profound when considering that students using repayment options like IBR may not actually be remitting monthly payments (or may not be paying a substantial amount), but may still have not defaulted on their educational loans.[80] In its first draft of the rule, the Department settled upon counting a loan as "repaid if the borrower (1) made loan payments . . . that reduced the outstanding principal balance, (2) made qualifying payments on the loan under the Public Service Loan Forgiveness Program . . . , or (3) paid the loan in full."[81] Thus, students using IBR would count toward their institution's repayment rate if their payments were sufficient to cover the accrued interest and some amount of the outstanding principal; otherwise, the student would be considered in default for purposes of these calculations. However, after receiving significant opposition to this position, the Department determined that "borrowers who meet their obligations under income-sensitive repayment plans are considered to be successfully repaying their loans even if their payments are smaller than accrued interest, so long as the program at issue does not have unusually large numbers of students in those categories."[82] Therefore, for-profit institutions no longer have to fear their graduates utilizing the IBR option. Under this test, however, a program is not judged by the median student

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78. *Id.* at 344, 52-53.

79. *Id.*

80. *See supra* notes 43-56 and accompanying text. The Department is not the only government organization struggling with how to classify students who have not defaulted on their loans but are otherwise not making payments capable of reducing their debt. The bankruptcy courts have begun to address whether students who repay under IBR can discharge their debt despite being required to pay nothing on their loans. *See, e.g.*, Marshall v. Student Loan Corp. (In re Marshall), 430 B.R. 809 (Bankr. S.D. Ohio 2010); Vargas v. Educ. Credit Mgmt. Corp. (In re Vargas), No. 08-82824, 2010 WL 148632, at *4 n.2 (Bankr. C.D. Ill. Jan. 12, 2010); Buckland v. Educ. Credit Mgmt. Corp. (In re Buckland), 424 B.R. 883 (Bankr. D. Kan. 2010).

81. Rulemaking, *supra* note 56, at 43619.

82. Program Integrity: Gainful Employment—Debt Measures, 76 Fed. Reg. 34386, 34389 (June 13, 2011) (to be codified at 34 C.F.R. pt. 668).

debt as it would under the debt-to-income test, but rather by the program’s aggregate student debt over the previous four years.[83]

For all but the colleges and universities that fall into the least restrictive category (those in category three with at least a forty-five percent repayment rate), a debt warning is required for incoming students.[84] The warning requirement has two components. First, the institution is required to place a “prominent warning” on all marketing and admissions materials, and counselors are required to provide an oral warning when conducting a meeting with potential students.[85] The warning must remind students “they may have difficulty repaying [their] loans obtained for attending that program.”[86] The second requirement is institution-specific. A qualifying institution must disclose both the result of its debt-to-income ratio test and the repayment rate of its recent graduates.[87]

Programs in the “restricted” category face the same debt-warning requirements just described and two additional burdens.[88] First, the institution is required to obtain affirmations from non-affiliated employers that “the curriculum of the . . . program aligns with recognized occupations at those employers’ businesses, and that there are projected job vacancies or expected demand for those occupations at those businesses.”[89] Program administrators are required to keep the size of the programs in line with the anticipated needs of employers.[90] Second, the institution may enroll only as many students receiving federal student loans as it had over the average of the previous three years.[91] Thus, under this requirement, an institution may enroll as many students as it wishes provided that the number of students receiving federal student loans does not exceed the three-year average.[92] Together, these requirements are designed to prevent higher-risk programs from growing any larger and to help align the size of graduating classes with the needs of employers.

83. Rulemaking, *supra* note 56, at 43638.

84. *Id.* at 43639.

85. *Id.*

86. *Id.* This type of warning has been used previously in other industries such as the securities industry when the government has attempted to correct informational asymmetries. *See, e.g.*, Conditions to Permissible Post-Filing Free Writing Prospectuses, 17 C.F.R. § 230.433(c)(2) (2011) (describing the requirements for a written legend warning of risks of investment that must accompany marketing materials sent by the securities issuer).

87. Rulemaking, *supra* note 56, at 43639.

88. *Id.*

89. *Id.*

90. *Id.* at 43, 63940.

91. *Id.* at 43, 639.

92. Students who are not eligible for federal student loans under this requirement have the alternative option of private student loans.

The "death penalty" restriction is reserved for the worst offending institutions. If an institution is not able to satisfy any of the debt criteria, its students are no longer eligible for any federal student loans.[93] Students currently in attendance at those institutions remain eligible in the year that the restriction comes into effect and for one additional year after that.[94] This one- to two-year window, however, is probably sufficient to steer away at least some current students who use or anticipate using at least some federal student assistance to finance their education. The Department estimates that up to five percent of programs would currently fail both the repayment rate and debt-to-income ratio tests, covering about eight percent of the students currently enrolled in for-profit colleges or universities, some 300,000 students.[95] Significantly, however, in its final promulgation of the rule, the Department reserved the "death penalty" punishment for only those institutions that failed both tests for three out of four consecutive years.[96] In addition, this penalty can apply to no more than five percent of the for-profit industry (weighted by total enrollment) in a single fiscal year.[97] This change significantly reduced the impact a single year's metrics could have on an institution's standing with the Department.

The final provision of the rule restricts the ability of for-profit colleges and universities to create new programs at will. The first requirement of any new program is that the institution provides to the Department of Education the projected enrollment of the program during its first five years.[98] Second, the institution must provide the same type of employer verification needed for restricted-status programs to continue to operate.[99] The Secretary then makes a determination based on available labor statistics to determine if the program is eligible for federal student loans, and, if so, if the program should be placed in either restricted- or debt-warning status.[100]

The Department has identified several reasons to institute this rule. While for-profit institutions insist their success is a necessary component of President Obama's plan to have the United States lead the world in college and university graduates by 2020,[101] there are systematic problems with generating too many graduates whose degrees do not lead to "measurable

93. Rulemaking, *supra* note 56, at 43639.

94. *Id.*

95. *Id.* at 43671.

96. Program Integrity: Gainful Employment—Debt Measures, 76 Fed. Reg. 34386, 34389 (June 13, 2011) (to be codified at 34 C.F.R. pt. 668).

97. *Id.*

98. Rulemaking, supra note 58, at 43639.

99. *Id.* at 43639-40.

100. *Id.*

101. *See* Jennifer Gonzalez, *For-Profit Colleges, Growing Fast, Say They Are Key to Obama's Degree Goals*, CHRON. HIGHER EDUC., Nov. 8, 2009, *available at* http://chronicle.com/article/For-Profit-Colleges-Say-The/49068/.

outcomes."[102] As the ratio of for-profit graduates increases relative to graduates of other types of institutions, the overall value of the degree in question will drop unless the for-profit degree holder is capable of performing to the same level as those who hold degrees in the same field from not-for-profit institutions.[103] To prevent the value of college or university degrees from being diluted, the Department determined it was necessary to intervene in order to ensure that graduates had employment opportunities upon leaving school.[104] Rather than regulating the types of programs offered and the manner in which they are offered, the Department chose to regulate based on the financial outcomes of each program's graduates.[105]

A second consideration was concern for the student. Students from for-profit institutions often find themselves deep in debt post-graduation with academic credentials that do not translate into real-world benefits.[106] The Department has expressed its interest that student recipients of federal student loans are not only eventually able to repay their loans, but also that the loans are not "unduly burden[some]."[107] Even students who are able to repay their loans in ten years or longer may be unduly burdened during that process. Sandy Baum and Saul Schwartz, whose information was relied on by the Department in making this rule, recommend that a student's annual loan payments not exceed eight percent of annual income.[108] IBR would cap a student's payments at slightly less than fifteen percent of his or her income. Lenders of other financial products such as mortgages and car loans have also used the "eight percent rule" in determining whether a borrower in student loan repayment qualifies for the best interest rates.[109] Burdensome loans also have a significant impact on retirement savings. Many students face the difficult choice between beginning to save for

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102. Rulemaking, *supra* note 56, at 43617.

103. *Id.*

104. *Id.* This does not necessarily mean that for-profit colleges and universities are *per se* precluded from offering liberal arts degrees. *See, e.g.,* List of Bachelor's Degree Programs, AM. PUB. UNIV. http://www.apu.apus.edu/academic/programs/bachelors (last visited Nov. 17, 2011).

105. Rulemaking, *supra* note 56, at 43617.

106. *Id.* at 43622.

107. *Id.* at 43621-22.

108. SANDY BAUM & SAUL SCHWARTZ, COLL. BD., HOW MUCH DEBT IS TOO MUCH?: DEFINING BENCHMARKS FOR MANAGEABLE STUDENT DEBT 2 (2006), *available at* http://professionals.collegeboard.com/data-reports-research/cb/debt. The study also suggests that the "eight percent rule" is not as significant for those with high incomes.

109. PATRICIA M. SCHERSCHEL, USA GRP. FOUND., STUDENT INDEBTEDNESS: ARE BORROWERS PUSHING THE LIMITS? 6 (1998), *available at* http://www.luminafoundation.org/publications/studentindebtedness.pdf.

retirement and servicing their educational loans.[110] Thus students' educational debts negatively affect their ability to borrow in the short term as well as their ability to accumulate wealth and save appropriately for retirement in the long term. This concern caused the Department to incorporate the debt-to-income ratio as part of their integrity test.[111]

Another concern of the Department is the taxpayer subsidies for those students in repayment who follow an alternative repayment path different from the typical ten-year standard repayment plan.[112] These alternatives can be costly endeavors for the government. As discussed above, IBR can significantly reduce the value (to the lender) of a loan. If a student is not able to achieve a high enough income over his or her repayment period, it is possible that the government will not receive enough payments to begin to cover the principal, let alone have payments that keep up with the accrued interest.[113] IBR and other income-sensitive repayment plans are designed to be a social safety net, not to be factored into students' own repayment calculus as they assess their educational options.[114] In addition to subsidized repayment plans, high-debt individuals are also common users of loan-deferment or forbearance. For some loans in deferment—normally while the student is attending school at least part-time and for six months after—the federal government will pay the interest due on the loan.[115] While subsidizing certain loans is part of Congress's plan to make higher education more accessible and affordable, subsidizing loans that do not result in gainful employment or in a substantial chance at repayment is throwing good money after bad. The Department estimates that three years

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110. *See Retirement Savings Versus Student Loans*, MOOLANOMY (Aug. 19, 2008), http://www.moolanomy.com/782/retirement-savings-versus-student-loans/ (last visited Jan. 17, 2011). Without careful analysis, students sometimes pay off their loans *too* quickly and fail to take advantage of more advantageous ways of directing their money. For example, students may not maximize an employer-matching 401(k) plan, which may be a better yield than the interest charged to them on their educational loans.

111. Rulemaking, *supra* note 56, at 43621-22.

112. *Id.*

113. *See supra* Table 2. It is also significant, although not addressed in this paper, that students can act strategically in order to maximize the subsidies to them. For example, students may realize before they graduate that there is no potential of paying back their educational loans and maximize their borrowing with the expectation that every additional dollar borrowed will likely never have to be repaid.

114. *See supra* note 58 and accompanying text.

115. 20 U.S.C.A § 1078 (West 2011). The Federal Subsidized Stafford loan can also be subsidized if the student chooses to enroll in IBR. If the student's proportional payment due on the subsidized loan is not enough to cover the interest payment, the government will continue to pay the unpaid amount for up to three years after deferment ends. 20 U.S.C.A. 1098e(b)(3) (West 2011).

of deferment may cost the government "up to twenty percent of the value of the loan."[116] In addition, "forbearance" is available to students in repayment in some circumstances.[117] For example, the Department can reduce or temporarily eliminate the payments of an individual student if he or she is facing certain hardships, such as serious medical problems, inability to find full-time employment, and other types of economic and financial difficulty.[118] Forbearance, under the right conditions, is also available for the same type of deferment subsidies described above.[119] In light of the fact that many students' deferment periods last well beyond four years and that forbearance is available to many students who are not able to find gainful employment, the government is right to reconsider subsidizing educations that are unlikely to lead to a debt-servicing level of income. While this phenomenon is experienced by some graduates of all types of higher education institutions, the degree and frequency that it occurs among graduates of for-profit institutions make them the "low-hanging fruit" for regulators.

An additional concern is the possibility of a student defaulting on his or her educational loans. In the years 2007-08, four out of every 100 students who attended a public or private not-for-profit college or university defaulted on their educational loans.[120] During the same time period, eighteen out of every 100 students who attended a for-profit college or university defaulted on their student debt.[121] Graduates of for-profit institutions offering a four-year program are particularly vulnerable, as twenty-five percent of all new graduates from those programs default on their loans.[122] Because defaults impose a cost on taxpayers, the Department has a strong interest in protecting its investment in students' education. In 2009, $9.2 billion worth of student loans went into default, an amount that the Department estimates to have a $1 billion net present value.[123] Estimates created prior to the Department's rulemaking stated that more than $274 billion in loans will go into default in 2020 alone.[124]

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116. Rulemaking, *supra* note 56, at 43622.

117. 34 C.F.R. § 685.204-05 (2009). In most circumstances, the Secretary of Education has at least some discretion in granting forbearance. Some of the reasons contemplated by the regulation include medical problems, military service, bankruptcy, a degree or certificate track internship, or any economic hardship that results in the student paying more than twenty percent of his discretionary income. For some circumstances, a three-year limit applies to the forbearance, but others may go on indefinitely subject only to an annual review by the Secretary.

118. *Id.*

119. *Id.*

120. Rulemaking, *supra* note 56, at 43652.

121. *Id.*

122. *Id.* at 43653.

123. *Id.* at 43622.

124. EISMAN, *supra* note 66, at 40.

While financial incentives alone might be enough to serve as a catalyst for change, the Department also has a broader social concern associated with students defaulting on their loans. The Department has determined that defaults have a large negative impact on many former students in that they find it more difficult to obtain credit for houses, cars, or even further education.[125] In addition, a stigma is often attached to students experiencing financial ruin as a result of their educational choices. Their peers, observing the negative consequences of taking out student loans, may be dissuaded from pursuing their own education.[126] This has the unwanted effect of reducing the overall education level of the nation.[127]

A final concern is to correct the information asymmetry that exists in higher education. Students who attend for-profit colleges and universities are more likely to belong to low-income and racial or ethnic minority groups than are students at public or not-for-profit institutions.[128] While low-income and minority groups are more likely to suffer the financial pains of educational debt, "only about half of the difference in defaults [can] be explained by student characteristics."[129] The Department and others believe that the other half is, at least in part, attributable to the characteristics of the institution.[130] There is a significant worry that students (and often their parents) lack the ability to properly analyze their options with respect to educational financing.[131] The fear is that "for-profit colleges use aggressive advertising to attract students from low-income families that lack financial sophistication and the ability to evaluate the benefits of attending a for-profit college."[132] The rule purports to address this concern in two ways. First, by requiring all but the "best" for-profit institutions to provide a debt warning to their students, the Department is taking a step toward eroding the information asymmetry and making sure to provide at least a basic warning before students arrange their financing.[133] Second, by restricting or eliminating entirely federal funding for the most at-risk programs, the rule may well steer would-be students

125. Rulemaking, *supra* note 56, at 43622.

126. *Id.*

127. *Id.*

128. JONATHAN GURYAN & MATTHEW THOMPSON, CHARLES RIVER ASSOCIATES, REPORT ON GAINFUL EMPLOYMENT: EXECUTIVE SUMMARY 2 (2010), *available at* http://www.docstoc.com/docs/43569247/Report-on-Gainful-Employment-Executive-Summary.

129. Rulemaking, *supra* note 58, at 43654.

130. *Id.* at 43654-55.

131. *See* Richard Posner, *The Controversy over For-Profit Colleges*, BECKER-POSNER BLOG, June 20, 2002, http://www.becker-posner-blog.com/2010/06/the-controversy-over-forprofit-collegesposner.html.

132. *Id.*

133. *See supra* notes 86-89 and accompanying text.

toward other institutions or, in the alternative, at least away from the most at-risk educational debt.[134]

This rulemaking was a response to the current and foreseeable state of for-profit education and to the crisis of student debt facing the country. The final rule represents the product of the Department of Education’s own views and the views contained in the more than 90,000 comments submitted during the request for comment period.[135] There have been many criticisms of the rule itself and of goals the rule purports to accomplish. The remainder of this paper will focus on critiquing this new regulation both in its purpose and in its structure.

II. CRITICISM OF THE “GAINFUL EMPLOYMENT” REGULATION

A. Public Comments

It is no surprise that reaction to this rulemaking has been large and bi-polar. The regulation, if it is sustained in the courts, will likely redistribute billions of dollars in the education industry and, in many cases, out of the for-profit sector entirely.[136] This regulation, combined with the anti-fraud regulations adopted before it, poses a serious threat to the very existence of many institutions, and certainly to the profit margins of all of them. Naturally, groups representing the for-profit higher-education industry were outspoken about their aversion to the rule. The 90,000 comments submitted to the Department of Education are strong evidence of the perceived importance of this rulemaking. However, skipping over the superfluous comments, there are several critiques that are intellectually honest and go after the substance of the rule itself. The Department has responded to those comments regarding the acceptance of new programs that, in its opinion, warrant a substantial response.[137]

One of the significant criticisms by the groups supporting for-profit colleges and universities is the use of eight percent of income as the high water mark above which debt payments are considered excessive. The Department relied heavily on an individual study sponsored by The College Board.[138] The Baum and Schwartz study, it is contended, was not a scientific study and the eight percent threshold was used because it had been a number used by mortgage underwriters years ago and long since abandoned.[139] Advocates of for-profit higher education point to specific

134. *Id.*

135. *See* Program Integrity, *supra* note 71, at 66665.

136. Rulemaking, *supra* note 58, at 43676-88.

137. *See* Program Integrity, *supra* note 71, at 66665. For a complete list of public comments on this regulation, see www.regulations.gov.

138. *See supra* notes 108-111 and accompanying text.

139. *See* CAREER COLL. ASS’N, COMMENTS OF THE CAREER COLLEGE ASSOCIATION 35-36 (2010).

references within the study itself where the authors admit that the eight percent criterion is not supported by evidence; they point to other parts of the study where the authors use twenty percent as a benchmark as well.[140] Because of this, the commenters supporting for-profit institutions suggest that to rely upon the study as a basis for judging the entire industry is not only arbitrary, but also has potential to have a profound negative effect on hundreds of thousands of students.[141]

Another common criticism of the regulation is that the metrics focus on the short-term success of the students to the exclusion of other criteria that are more indicative of the students' long-term success. Critics claim that the Department's focus on only the early years after students complete their education is flawed. In their view, the benefits of a college or university degree accrue throughout a whole lifetime; thus, the Department should use a metric that is more appropriately designed to measure educational outcomes over the entirety of a student's career.[142] A study by Guryan and Thompson that was commonly cited by many for-profit commenters stated cogently:

> [T]he basis of the debt limit on earnings early in the career stands in contrast with standard economic analysis of education, which clearly says that the choice of how much to borrow for schooling should be based on the benefits of schooling, and not on the earnings level at the beginning of a career. Any proposal aimed at helping students make smart decisions about investments in education should compare the costs of schooling to the gains that accrue over the full career as a result of that schooling. It should not compare costs to the level of earnings of recent graduates.[143]

Critics have also stated that the Department is not correct to claim that students of for-profit colleges and universities are significantly more likely to default simply because they attended a for-profit institution. By the Department's own admission, over half of the difference in default rates can be accounted for by student characteristics such as socioeconomic class, ethnicity, and race.[144] The critics claim that had the Department controlled for other student characteristics, the default gap would be substantially diminished.[145] The Department counters by stating that it controlled for the most significant student characteristics including "race, gender, persistence and completion, Pell Grant receipt, family Aid to

140. *Id.*
141. *Id.*
142. *See* GURYAN & THOMPSON, *supra* note 130, at 3.
143. *Id.*
144. Rulemaking, *supra* note 58, at 43654.
145. *See* GURYAN & THOMPSON, *supra* note 130, at 3.

Families with Dependent Children receipt, income, and dependency status."[146]

Some commenters also called for better treatment of students who attend institutions that are deemed ineligible. Under the rule, these students would continue to be eligible for federal loans for the remainder of the year the program becomes ineligible and then for one year after that.[147] For students who recently began a four-year program, it is likely that they would not be eligible to complete the program with federal educational assistance. This may require those students to transfer or completely abandon their educational path altogether. Commenters have suggested that the Department consider remedies for this category of students, such as discharge of the loans the student has already taken out.[148]

One of the more contentious points has revolved around the employer affirmations requirement necessary for programs facing restricted status and for any new program to be added.[149] For-profit groups have suggested that this requirement is far too burdensome; they suggest that employers will be unwilling to supply these affirmations out of fear they will be obligated to hire that number of graduates.[150] Others claim that the costs associated with collection of this information are too high.[151] Critics have also pointed to certain ambiguities in the affirmations, such as how far of a distance institutions will be permitted to go to obtain these affirmations.[152]

B.Legislative Reaction

The regulation has not gone unnoticed by Congress. Senator Harkin of Iowa, Chairman of the Senate Committee on Health, Education, Labor, and Pensions, has held several hearings on the state of the for-profit education industry and has indicated that he may introduce legislation that goes beyond what the Department has proposed in terms of restricting these

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146. Rulemaking, *supra* note 58, at 43654 n.16. For a thorough discussion of student characteristics and how they relate to debt, see SANDY BAUM & DIANE SAUNDERS, NAT'L STUDENT LOAN SURVEY, LIFE AFTER DEBT: RESULTS OF THE NATIONAL STUDENT LOAN SURVEY 31-37 (2008), *available at* http://www.nelliemae.com/pdf/NASLS.pdf.

147. *See supra* notes 95-99 and accompanying text.

148. *See* MOLLY CORBETT BROAD, AM. COUNCIL ON EDUC., COMMENTS ON PROGRAM INTEGRITY RULES 6 (2010), *available at* http://www.nacua.org/documents/ACE_Letter_GainfulEmployment.pdf.

149. *See supra* notes 91-92, 100-102 and accompanying text.

150. Program Integrity, *supra* note 71, at 66666-67.

151. *Id.*

152. *Id.* This raises the sub-issue of whether for-profit institutions should consider the mobility of their students after graduation. This also presents a particular problem for institutions that offer online courses and have a national student population.

institutions.[153] The for-profit institutions, however, do have some allies. During the 2010 election cycle, for-profit colleges and universities made political contributions to more than 200 lawmakers' campaigns.[154] John Cline, chairman of the House Education and Workforce Committee, threatened to stop the rule from taking effect altogether.[155] While no legislation has left the committee stage as this note goes to press, lobbying Congress may be the industry's best hope of preventing implementation of the new regulation.

C.Judicial Intervention

The Association of Private Sector Colleges and Universities (APSCU) filed suit in the United States District Court for the District of Columbia challenging the authority of the Department of Education to promulgate such regulations.[156] The plaintiffs have previously claimed that the Department lacks the legal authority to impose these types of regulations on the for-profit education industry.[157] The plaintiffs argue, *inter alia*, that the rule goes further than the statutory requirement of *preparing* students for gainful employment, but rather requires that the students actually achieve such employment. The Department maintains that "it is charged with the responsibility to ensure that institutions participating in these [federal loan] programs have the financial strength and administrative capability to do so."[158] Outside of the possibility of a procedural misstep by the Department, it appears that the authority of the Department to design and adopt the rule under the Higher Education Act will be the key issue in the courts.

III. CONCLUSION

For better or for worse, higher education is changing. The recent adoption of programs such as Direct Lending and IBR have simultaneously made higher education more accessible and increased the possibility that student loans may never be repaid. The new regulation by the Department of Education may be just the first step in an attempt by the federal government to rein in loans likely to default. Having an educated population is an important societal interest, and easily accessible education is widely regarded as a public good. When taxpayer dollars are subsidizing

153. *See* Diane Bartz, *Analysis: For-Profit Schools Attack Reform Rule by Lobbying*, REUTERS, Jan. 12, 2011, http://www.reuters.com/article/idUSTRE70B6T020110112?pageNumber=1.

154. *Id.*

155. *Id.*

156. Career Coll. Ass'n v. Duncan, 2011 WL 2690406 (D.D.C. July 12, 2011).

157. *See* CAREER COLL. ASS'N, *supra* note 141, at 12-16.

158. Program Integrity, *supra* note 71, at 66668.

our nation’s students, however, there is an equally compelling interest in seeing to it that those dollars are being spent productively.

If the new regulation is sustained by the judiciary, it will mark the first attempt to improve both the quality and affordability of the for-profit higher education industry. The goal is that through these regulations or some other legal or market mechanism, students who attend these schools will begin to make educational decisions that lead to better post-graduation outcomes.