Measuring Your Gainfulness: The DOE's New Gainful Employment Metrics

A Special Regulatory Update

By Ronald Holt and Megan Banks, Dunn & Davison LLC

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Measuring Your Gainfulness: The DOE's New Gainful Employment Metrics

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On June 13, 2011, the Department of Education (DOE) promulgated final regulations setting forth metric standards that must be satisfied by any academic program classified as a gainful employment program eligible for Title IV aid. The new regulations and their accompanying preamble are published at 76 Fed. Reg. 34386 (June 13, 2011) and can be found on the DOE's financial aid Web site, http://www.ifap.ed.gov/ifap/, under the "Federal Registers" tab.

In announcing these final gainful employment standards in a June 2, 2011 press release, Secretary of Education Arne Duncan declared that the Department had "worked hard to ensure that the final regulation does the best job of protecting students and taxpayers by targeting the worst-performing schools and supporting schools that do a good job of preparing graduates for success in the workplace." While it is true that the final regulations are less draconian than the standards proposed in late July 2010 by the Secretary, we are not persuaded that these final regulations will only sanction the "worst-performing schools" and instead we are reminded of what the noted Missouri author and pundit Mark Twain once said, "There are three kinds of lies—lies, damned lies and statistics." But, no matter how unwise, unfair and objectionable these final gainful employment regulations may be,[1] unless overruled by the Congress or a federal court, they are the law and now govern the eligibility of nearly all programs offered by for-profit institutions and all non-degree programs offered by nonprofit institutions.

Although the regulations do not become effective until July 1, 2012, and failing programs will, at the earliest, lose eligibility in 2015, it is imperative that these regulations be examined and understood now, because the relevant data to be used in the calculations will largely involve students who have already left their programs. Thus, the time period during which schools can affect any change to their ultimate outcomes is rapidly dwindling. The following is a brief overview of the new gainful employment regulations.

Definition of Gainful Employment Program. The new regulations apply to "gainful employment" programs, which, subject to a few limited exceptions (i.e., certain baccalaureate, teacher certification and preparatory programs), consist of all Title IV eligible programs offered by for-profit institutions and all non-degree Title IV eligible programs offered by non-profit institutions. Individual programs are identified by combining the institution's OPEID and the program's CIP code and credential level.

The Ratios. Effective with the fiscal year ending September 30, 2012, every gainful employment program must pass at least one of the following three debt measures:

- Loan Repayment Rate (LRR): At least **35%** of the program's former students are repaying their loans.

- Debt-to-Earnings Ratio (DTE): There are two DTE measures, either of which can be satisfied to maintain eligibility:

  - *Actual Earnings:* The median annual loan payment for program graduates does not exceed **12%** of average graduate total annual earnings.

  - *Discretionary Earnings:* The median annual loan payment for program graduates does not exceed **30%** of average graduate annual discretionary income.

The Cohort. All three debt measures generally examine students who graduate (for DTE ratios) and borrowers entering repayment (for the LRR) during the third and fourth years

prior to the 'debt measure' year, which is a federal fiscal year. The DTE metric covers all program graduates (including those who did not receive Title IV funds and those who were not placed in employment), excluding any graduates who, during the so-called earnings calendar year (explained below), had an in-school or military deferment or died or became disabled. The LRR metric covers all program graduates and withdrawals or drops, excluding those borrowers who, during the 'repayment year' (explained below) had an in-school or military deferment, died or became disabled. For example, for the 2012 debt measures (which are issued for the fiscal year ending September 30, 2012), the typical cohort will be comprised of graduates (for the DTE measures) and borrowers who entered repayment (for the LRR measure) during fiscal years 2008 and 2009. There are a few exceptions:

– Transition Period: For debt measures issued for fiscal years 2012, 2013, and 2014, as an alternative measure, the LRR measure may be calculated based on borrowers who entered repayment during the two most recent fiscal years, instead of the third and fourth prior years. Thus, for the 2012 fiscal year debt measures, the cohort could be comprised of borrowers who entered repayment during fiscal years 2010 and 2011, instead of fiscal years 2008 and 2009.

– Small Number of Borrowers: With respect to the DTE measures, if there are 30 or fewer borrowers in the third and fourth prior fiscal years, the time period will be expanded to include the fifth and sixth prior fiscal years. For the 2012 fiscal year debt measures, this cohort would now include borrowers who entered repayment during fiscal years 2006, 2007, 2008, and 2009. If there are still 30 or fewer borrowers in the expanded cohort, the program will be deemed to have passed the DTE measures.

– Medical and Dental Programs: If a program requires completion of a medical or dental internship, the debt measures will be calculated using the sixth and seventh prior fiscal years. For example, for the 2012 fiscal year debt measures, the cohort would be comprised of graduates (DTE measures) and borrowers who entered repayment (LRR measure) during fiscal years 2005 and 2006.

As explained below, the earliest any program could lose eligibility is early 2015, based on the debt measures issued for fiscal years 2012, 2013, and 2014. However, most of the students that will be used to calculate the LRR and DTE rates for those first three debt measure fiscal years have already left their programs, because, for most programs, the 2012 debt measures will examine students who graduated or entered repayment in fiscal years 2008 and 2009, the 2013 debt measures will examine students who graduated or entered repayment in fiscal years 2009 and 2010, and the 2014 debt measures will examine students who graduated or entered repayment in fiscal years 2010 and 2011 (ending September 30, 2011).

This is illustrated in the chart below.

Given this dynamic, it is imperative that institutions begin working now to influence the data used to compute the debt measures.

	FY 2012	FY 2013	FY 2014
Reported	Early 2013	Early 2014	Early 2015
Cohort (assuming no exception)	FY 2008 FY 2009	FY 2009 FY 2010	FY 2010 FY 2011
In School Now?	NO	NO	Until September 30
Earnings Year (DTE)	CY 2011	CY 2012	CY 2013
Repayment Year (LRR)	FY 2012	FY 2013	FY 2014

Mechanics.

Loan Repayment Rate (LRR). The LRR will be calculated using the following ratio:

$$\frac{\text{OOPB of LPF plus OOPB of PML}}{\text{OOPB}}$$

It looks scary, right? Here is how it is broken down:

– Original Outstanding Principal Balance (OOPB): The amount of the outstanding balance on the loan for all cohort borrowers at the beginning of the 'repayment' fiscal year, which is the same fiscal year as the debt measure year. Balance includes principal, capitalized interest and any accrued but not yet capitalized interest, on FFEL and Direct Loans owed by students in the relevant cohort. The equation will not include loans made to parent borrowers, loans in military or in-school deferment, or loans discharged due to the borrower's death or disability. The equation will include loans in deferment or forbearance.

– Loans Paid in Full (LPF): Those loans that have never been in default and have been paid in full by or during the 'repayment' year.

– Payments Made Loans (PML): Those loans that have never been in default and fall into one of the following categories:

- The loan's balance is reduced by the end of the 'repayment' year from what it was at the beginning of the 'repayment' year, by as little as $1.00.
- The loan is in the process of qualifying for Public Service Loan Forgiveness.
- The borrower has qualified for an interest-only or income-based repayment plan and is current on his or her payments. To prevent 'abuse' of this exception, the total dollar amount of loans of this nature that can be included in the numerator is limited to 3% of the OOPB of all loans in the denominator.
- For graduate program consolidation loans, the loan's balance is not increased during the 'repayment' year.

Here's an example that would result in a LRR of 42.5%:

$$\frac{\$10{,}000 \text{ (OOPB of LPF)} + \$75{,}000 \text{ (OOPB of PML)}}{\$200{,}000}$$

The structure of this calculation means that higher value loans will affect the rate more significantly, as the LRR uses the value of the loans that are being repaid, not the number of borrowers that are repaying. In other words, schools will gain greater benefit in the LRR if their borrowers with the highest balance loans make enough payments during the 'repayment' year to reduce the balance from where it was at the beginning of the 'repayment' year. At a minimum, this means a borrower's payments will have to at least total to the amount of all interest accruing during the repayment year plus $1.00.

Debt-to-Earnings (DTE). The DTE ratios are each calculated by dividing the amount of the **annual loan payments** required for median debt of program graduates by the greater of the mean or median of either program graduates' **actual earnings** (an acceptable ratio can be no greater than 12%) or **discretionary income** (an acceptable ratio can be no greater than 30%). The median is the middle value in a set of numbers (in an even set of numbers the median is the average of the middle two numbers), while the mean is the average value, computed by adding the numbers and dividing by their total count.

– Annual Loan Payment: The annual loan payment is based on the median loan debt for all program graduates in the cohort. A few important notes:

- Loan debt for each graduate includes all Title IV loans, private loans, and any balance outstanding at graduation on an institutional loan or payment plan.

- The calculation of annual debt service on median debt uses the current interest rate for Unsubsidized Direct Loans and the following amortization terms: 10-year repayment plan for certificate and associate's degree programs; 15-year repayment plan for bachelor's and master's degree programs; and 20-year repayment plan for doctoral and professional degree programs.
- For purpose of determining each graduate's program debt to be used in the distribution of debt values for all program graduates that determine median program debt, the graduate's debt will be the lesser of total actual debt or total institutional charges. This provision purportedly was intended to exclude debt incurred for living expenses from the calculations. However, this is diminished because the effect of Pell Grants is not considered in the calculation, so, for example, if total institutional charges are $10,000, the student receives a Pell Grant of $5,000, and incurs total debt of $12,000 ($7,000 of which is for living expenses), the gainful employment debt reported for this student will be $10,000 (even though only $5,000 of that was used to pay institutional charges).
- If a student has been enrolled in multiple sequential programs at the same institution, the loan debt for all programs will be attributed to the highest credentialed program completed by the student.
- Loan debt incurred in connection with programs at other institutions will not be included, unless the subject institution and the other institution are under common ownership.

– Actual Earnings: Annual actual earnings of program graduates during the 'earnings year'

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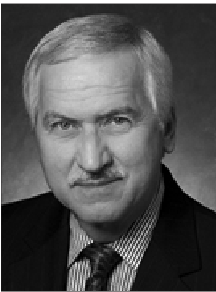

RONALD HOLT brings 26 years of experience in a broad range of commercial and general litigation matters in various industries regionally and across the country. He has a national practice representing institutions of higher learning in litigation, regulatory matters and business transactions.

Ron served a two-year clerkship with the late United States District Judge Russell G. Clark before entering private practice. He has served as lead counsel and successfully prosecuted and defended substantial claims in commercial, banking, antitrust, securities, environmental, employment, insurance and higher education litigation matters, including complex commercial cases.

Active in representing for-profit postsecondary institutions around the nation, Ron is a member of the Association of Private Sector Colleges and Universities headquartered in Washington, D.C., where he serves on its Legislative Advisory Council and chairs its Litigation Committee.

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will be calculated by using the higher of the mean or median amount of earnings reported to the Social Security Administration (SSA), for all graduates in the cohort during the 'earnings year,' which is the calendar year prior to the debt measure fiscal year (for debt measure fiscal year 2012, this is calendar year 2011 earnings). A few important notes:

- Through a pre-draft rate correction process, institutions will be able to verify that the list of graduates submitted by DOE to SSA is correct and does not contain any excludable graduates (i.e., in-school, military, dead or disabled), but will not be able to review or challenge the reported earnings numbers.

- For debt measure fiscal years 2012, 2013, and 2014 and only those years, if a program fails all three debt measures, institutions will be allowed to request recalculation of the DTE ratios using 25th percentile earnings data from the Bureau of Labor Statistics (BLS) for the SOC code relevant to the programs. However, this option will only be available if the institution can demonstrate that at least 50% of program graduates in the cohort were placed in the occupation matching the applicable SOC code and the total number of such graduates is more than 30.

- If a program fails all three debt measures, either during the initial three debt measure years (FY 2012, 2013 and 2014) or any subsequent debt measure year, institutions will be allowed to recalculate the DTE ratios with alternative earnings numbers from two sources: (i) data based on institutional surveys (which must be conducted in accordance with relatively stringent NCES standards, involve more than 30 responding students and be validated by a CPA attestation), or (ii) actual earnings data maintained in a state longitudinal data system for at least 50% of the program graduates that must consist of more than 30 graduates.

  – Discretionary Income: Discretionary income is calculated by subtracting 150% of the single person Poverty Guideline (available at http://aspe.hhs.gov/poverty) from actual earnings. For calendar year 2011, the Poverty Guideline is $10,890, and 150% of that number is $16,335. Therefore, in order to satisfy this DTE metric at the present time, the annual loan payment (calculated using the appropriate amortization term) could not be more than 30% of the amount of actual average program graduate earnings that is above $16,335.

Debt Measure Releases and Appeals. In early 2012, the Department will issue 'informational' debt measures for fiscal year 2011, which will not be used to determine the qualification of a program and instead will serve as an early indication of how programs may fare under the new standards. But, beginning with debt measure fiscal year 2012, the Department will issue debt measures for programs that will count. And, beginning with the first official debt measure year, fiscal year 2012, the Department will issue draft results of the debt measures for each program. Prior to issuing the draft results and with respect to the DTE metrics, the Department will provide the institution with a list of students to be included in the cohort. The institution will have 30 days to provide evidence that certain students should either be included or excluded from the cohort or to provide corrected or updated identity information. The Department will then calculate and distribute to each institution draft debt measures, and the institution will have 45 days to challenge the accuracy of the loan amounts used for either the LRR or DTE metrics, or to challenge the accuracy of or correct or update identity information for the list of borrowers used to calculate the LRR (not the DTE). The Department will then notify the institution of the final debt measures, including any necessary corrections. If a program fails all three debt measures, as mentioned earlier, the institution may attempt to establish that the program would meet one of the DTE measures using alternative earnings data, such as BLS 25th percentile earnings (for debt measure fiscal years 2012–2014 only), state data, or survey data.

Sanctions: Warnings & Loss of Eligibility. If a gainful employment program fails all three debt measures for either one or two debt measure years out of three, the institution must provide certain warnings and disclosures to current and prospective students. After the first failure year, the institution must disclose to current and prospective students the failing metrics and plans for improvement. This 'warning' must be given directly to students, verbally or in writing. After the second failure year within a three consecutive year period, in addition to the first year warnings, the institution must disclose to current and prospective students its plans to address the failure and must warn such students that they may encounter difficulty repaying their loans, the program may become ineligible for Title IV funding, and if eligibility is lost, the consequences and options available to the program's students to continue their education at other institutions. In addition to being communicated directly to students, the second year warnings must be displayed on the program's Web site and in all promotional materials.

Both first- and second-year warnings must be presented in clear language and in an easily understandable format. And these warnings must be given to prospective students the first time a student has direct contact with a representative of the institution about the program, and to existing students, starting no later than 30 days after notice from the Department of the program's failure to satisfy the three debt measures. With both first- and second-year failures, a three-day waiting period is placed on enrollment. The institution must wait at least three days after providing the required warnings before enrolling a new student in the affected program (assuming that student intends to apply for Title IV funds), and if more than 30 days pass after the warnings were given, the institution must provide a new set of warnings and wait at least three days before enrolling the student.

If a program fails all three debt measures for a third time within four fiscal years, the program will lose Title IV eligibility and will not be able to re-establish eligibility for at least three fiscal years following the fiscal year in which eligibility was lost. If an institution voluntarily withdraws the program from Title IV no later than 90 days after the Department's notification requiring the second-year warnings, the program will be able to re-establish eligibility after two fiscal years. The earliest date by which any program will lose eligibility is early 2015, based on the debt measures for debt measure fiscal years 2012, 2013, and 2014. For this first possible year of eligibility loss only, the loss of Title IV eligibility will be capped at the worst 5% of all programs, i.e., those programs within the 5th percentile of the debt measures, for each of three categories of institutions: public, non-profit, and for-profit. The percentile rankings of programs, based on debt measure figures, will be by student count.

Closing Thoughts. There clearly are many nuances in these metrics that will require guidance from the Department, so stay tuned to the Department's gainful employment guidance, which you can find on the new gainful employment Web page at http://www.ifap.ed.gov/GainfulEmploymentInfo/index.html. The famed and brilliant physicist Albert Einstein once modestly said of his great scientific discoveries, "It's not because I am smarter than other people, but rather because I spend more time with problems." The gainful employment regulation, as a new Title IV litmus test for academic programs, is the 'problem' and institutions now need to begin to spend more time addressing that 'problem' on a program-by-program basis in order to identify operational changes that can yield a solution for the 'problem.'

Please note that the contents of this update article are not intended to be, nor do they constitute, legal or regulatory advice. Readers are encouraged to consult with their legal or regulatory counsel before making decisions or taking action concerning the issues addressed in this update.

[1] *We are not alone in questioning the wisdom and fairness of these regulations. In a July 1, 2011 press release commenting on the gainful employment regulations and the DOE's new credit hour, state authorization and incentive compensation regulations, Congressman John Kline, Chair of the U.S. House Committee on Education and the Workforce, stated, "The Department of Education has put in place a series of short-sighted and reckless regulations that will be detrimental to the nation's institutions of higher learning."*