

# How the “Gainful Employment” Rule Protects Students and Taxpayers



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What would you say if you heard that most students who graduated from a particular higher education program were unable to earn a salary above the poverty line? What if you found out that federal tax dollars continued to flow to these programs through grants, and students were still taking out federal loans to attend them, even though they’d have little chance of being able to pay them back?

In 2014, the Department of Education put into place “gainful employment” rules to address this problem and other alarming evidence of a quality crisis in our higher education system. There were major concerns that many students across the country were enrolling in career education programs that left them unable to find work and saddled with unmanageable debt. In fact, according to the newly released earnings data that was required under these rules, there are at least 1,700 career education programs across the country where graduates typically earned less than the federal poverty line (\$11,880).<sup>1</sup> That data only accounts for those who actually graduate, meaning that even the students who “succeeded” within these programs will still struggle to

provide for themselves on a day-to-day basis. Many other students who attended these programs failed to finish, almost ensuring a difficult route to a financially secure future. Not surprisingly, given those abysmal income numbers, at 3,400 of the career education programs covered by these rules, less than 50% of students are successfully repaying their loans—almost a third of all the programs to which the rules apply.<sup>2</sup>

Gainful employment regulations were put in place to help ensure that students and taxpayers were protected from high-cost, low-quality programs that are doing little to offer increased economic opportunity. Without the existence of these rules, even the most low-performing programs would continue to have access to taxpayer funds in the form of federal student aid. This memo offers a brief explanation of how the rules protect both students and taxpayers.

## **What is “gainful employment”?**

Gainful employment is a regulation that enforces a requirement in the *Higher Education Act* that states that career education programs must “prepare students for gainful employment in a recognized occupation” in order to be eligible for federal student aid.<sup>3</sup> The purpose of the regulation is to ensure that students who enter a career education program that promises to prepare them for a particular profession are provided with the necessary skills to find employment and repay their federal loans after graduation. For example, if a program advertises itself as preparing auto mechanics, hair dressers, or dental assistants, then at least a good portion of its students should be able to find employment in those fields after finishing that program—or the federal government should stop funding it with taxpayer dollars. Under the gainful employment rules, if most of a career education program’s graduates fail to make a high enough salary to sufficiently repay their loans, that program can no longer receive Title IV federal student aid dollars (taxpayer-funded grants or loans) to help fund its operations. hair dressers, or dental assistants, then at least a

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## **Who is covered by the gainful employment rules?**

While most people talk about the gainful employment rules as if they apply only to the for-profit sector, the regulations actually cover over 29,000 programs at all types of institutions, including many programs at for-profit schools and non-degree and certificate (career) programs at private and public colleges.<sup>4</sup> In fact, almost 3 in 10 (29%) of the programs covered within the most recent gainful employment data are at public colleges, including programs like the nursing program at Long Beach City College in California or the pharmacy technician program at Clark College in Washington.<sup>5</sup> Overall, this rule encompasses programs serving over 16 million students enrolled between 2008 and 2014. In 2013-2014 alone, there were over 2.6 million newly-enrolled students in career education programs that were covered by these gainful employment protections.<sup>6</sup>

## **What do schools have to do to comply?**

In order to continue to receive federal aid for programs covered under the gainful employment rules, institutions must comply with two basic requirements. First, they must provide their prospective students with information on outcomes before they enroll, such as graduation rates and job placement rates, so that students can see how well alumni have fared after completing the program. Second, they must demonstrate that their graduates earn enough to adequately repay their loans by meeting a certain debt-to-income ratio

for students who have graduated from each of their programs. This information is calculated by the Department of Education using two formulas:

- (1) A program's **annual income debt-to-earnings ratio** is calculated by dividing the average graduate's annual loan payment amount by either the mean or median annual earnings for its graduates, whichever is higher (i.e. *more generous to the program*). <sup>7</sup>
- (2) A program's **discretionary income ratio** is calculated by dividing the average graduate's annual loan payment by their discretionary income, which is defined as their earnings that exceed 150% of the federal poverty line (again taking the higher of the median or mean). This figure is supposed to measure whether a graduate earns enough to make loan payments after covering basic expenses.

To maintain eligibility to receive federal student aid dollars, a program's graduates must have a certain debt-to-income ratio by these two measures. The rule uses a pass/warning/fail system to help determine eligibility.

<b>PASS</b>	To pass the gainful employment requirements, a program's graduates must have annual loan payments that are less than 8% of total earnings <b>or</b> less than 20% of discretionary earnings.
<b>WARNING</b>	If a program does not fall into the passing category and its graduates have either annual loan payments between 8 and 12% of total earnings <b>or</b> between 20 and 30% of discretionary earnings, that program is considered to be a higher risk and is placed in the "warning zone."
<b>FAIL</b>	If a program's graduates have annual loan payments greater than 12% of total earnings <b>and</b> greater than 30% of discretionary earnings, the program is considered to have failed the requirements.

The system allows for either the annual income debt-to-earnings or discretionary income ratio to be used to obtain a passing or warning status, whichever one is better; however, **a program must fail both the annual income debt-to-earnings ratio and the discretionary income ratio to receive a failing rating for that year.**

To clarify how this would work in the real world, below is an example of this formula applied to a generic undergraduate certificate career education program. This program's graduates averaged \$15,000 in loans and made an annual

income of only \$25,000 after completing the program. The annual loan payment amount assumes a federal direct unsubsidized loan interest rate of 6.8% spread over a 10-year period. The current federal poverty line is \$11,880.

Annual Income  
Debt-to-Earnings Ratio

$$\frac{\$2,071}{\$25,000} = 8.3\%$$

Discretionary Income Ratio

$$\frac{\$2,071}{\$25,000 - (\$11,880 \times 150\%)} = 28.8\%$$

Because this program has an annual loan payment between 8 and 12% of total earnings and between 20 and 30% of discretionary earnings, it would have fallen into the warning category for this year. If either the annual income debt-to-earnings ratio or the discretionary income ratio would have fallen into the passing category, the entire program would have been considered passing. However, *both* metrics would have needed to have fallen into the failing category for the program to not have passed the gainful employment rule for that year.

It should be noted that career education programs that fail to meet these requirements do not lose access to federal student aid immediately, but are instead provided time to demonstrate improvement and show that their graduates are in fact becoming “gainfully employed.” In order to stop receiving federal student aid, a program must fail in two out of any three consecutive years or be in the “warning zone” for four consecutive years. When it released the rules, the Department estimated that 1,400 programs would not pass this test. These programs had around 840,000 students enrolled at the time of this estimate. <sup>8</sup>

## **Why do some people oppose the gainful employment rules?**

Not surprisingly, those in the career college industry have been resistant to increased oversight of their programs and have voiced strong opposition to the gainful employment regulations. The Association of Private Sector College and Universities (APSCU), an organization that represents for-

profit institutions, has been the strongest critic of these actions (now referred to as Career Education Colleges and Universities or CECU).

Specifically, the main criticism levied against this regulation is that it unfairly targets the for-profit industry, which sometimes offers more flexible schedules and programming for today's growing population of non-traditional and lower-income students. If an increasing number of these programs were discontinued, some argue that lower-income students would have fewer options to obtain a postsecondary credential. Others have contended that this rule should be applied not just to career education programs but to all students, in all programs, across all sectors of higher education.<sup>9</sup> (Right now, the rules do not apply to degree-granting programs at non-profit or public institutions.)

## **Weren't the gainful employment rules challenged in court?**

Yes, APSCU has filed two lawsuits to try to prevent the implementation of the gainful employment rules challenging the Department's authority to regulate in this area.<sup>10</sup> The first lawsuit filed by APSCU in 2011 was successful, invalidating the Department's first attempt to establish a gainful employment rule.<sup>11</sup> Within the initial set of rules that the Department proposed in 2010, career education programs would have had to exceed a 35% loan repayment rate, in addition to the debt-to-income thresholds present in the current rule, in order for its students to remain eligible to receive federal student aid. The judge in that ruling stated that:

*“The debt-to-income standards were based upon expert studies and industry practice — objective criteria upon which the department could reasonably rely...The debt repayment standard, by contrast, was not based upon any facts at all. No expert study or industry standard suggested that the rate selected by the department would appropriately measure whether a particular program adequately prepared its students. Instead, the*

*department simply explained that the chosen rate would identify the worst-performing quarter of programs.”<sup>12</sup>*

Because these three metrics were seen as intertwined, the initial set of gainful employment rules released in 2010 were invalidated.

The most current set of rules, made final in 2014, were also challenged by APSCU as being arbitrary and capricious. However, this time they were upheld, both by a U.S. District Court in 2015 and also by the U.S. Court of Appeals for the District of Columbia Circuit in 2016. In response to APSCU’s appeal, the Court of Appeals concluded that the gainful employment rules were consistent with congressional intent because,

*“It would be strange for Congress to loan out money to train students for jobs that were insufficiently remunerative to permit the students to repay their loans. And it would be a perverse system that, by design, wasted taxpayer money in order to impose crippling, credit-destroying debt on lower-income students and graduates. Had Congress been uninterested in whether the loan-funded training would result in a job that paid enough to satisfy loan debt, it would have created a federal grant system instead of a federal loan system focusing on preparation for gainful employment.”<sup>13</sup>*

## **What happens if the gainful employment rules are removed?**

If the gainful employment rules are removed by legislation or administrative action, it would jeopardize the welfare of students, taxpayers, and the federal budget. Students and families would no longer receive the critical information on each program made available to them *before* enrolling—such as how much students usually take out in loans and how much they typically earn after completing the program. Instead, students would enroll in these programs similarly to how they did pre-gainful employment rules, with little information on whether or not those programs are worthy of their investment.

Taxpayer dollars would also continue to fund programs that may have little return on investment. Because there would be less accountability and less information on the performance of these programs, federal dollars in the form of grants and loans would continue to flow to any program, regardless of their outcomes. Even programs with the least likelihood of students repaying their loans would continue to be funded with federal dollars.

Lastly, gainful employment will save the federal government money each year. According to the Department's final regulations, it is estimated that the rule will result in reduced costs of \$4.2 billion over the next decade, mainly due to Pell grants not expended between fiscal years 2014 and 2024.<sup>14</sup> Repealing this regulation would not only have consequences for students and taxpayers, but it would also result in a huge net loss to the federal government.

## Conclusion

With over \$150 billion in federal aid going to institutions each year, it is extremely important that institutions do a good job graduating its students and ensuring that they are well-trained and prepared to succeed in today's workforce. The gainful employment rules may not be perfect, but they are the best safeguard in the current system to ensure students and taxpayers aren't paying for programs that provide little or no value.

### TOPICS

HIGHER EDUCATION 110

### END NOTES

1. This is the most recent gainful employment earnings data as of this date, released on November 17, 2016. Accessed on December 2, 2016. Available at: <https://studentaid.ed.gov/sa/about/data-center/school/ge?src=press-release>.



- 2.** This analysis uses the most recently available data on loans taken within over 14,000 gainful employment programs. Accessed December 2, 2016. Available at: <https://studentaid.ed.gov/sa/about/data-center/school/ge/data>.
- 3.** United States, Congress, Senate, “H.R. 4137 - Higher Education Opportunity Act,” 110th Congress, Public Law No: 110-315, Section 101, 102 and 481, August 14, 2008. Accessed December 21, 2016. Available at: <https://www.congress.gov/bill/110th-congress/house-bill/4137/text>
- 4.** United States, U.S. Department of Education, “Education Department Releases Final Debt-to-Earnings Rates for Gainful Employment Programs,” Press Release. Accessed on January 17, 2016. Available at: <https://www.ed.gov/news/press-releases/education-department-releases-final-debt-earnings-rates-gainful-employment-programs>
- 5.** Ibid.
- 6.** United States, U.S. Department of Education, *Federal Register*, October 31, 2014, pp. 65,000-65,001.
- 7.** The annual loan payment is determined by amortizing the median loan debt for a cohort of graduates’ depending on which type of program they enrolled in. It is amortized over a 10-year repayment period for a program that leads to an undergraduate certificate, a post-baccalaureate certificate, an associate degree, or a graduate certificate; over a 15-year repayment period for a program that leads to a bachelor’s or master’s degree; or, over a 20-year repayment period for a program that leads to a doctoral or first professional degree.
- 8.** “Obama Administration Announces Final Rules to Protect Students from Poor-Performing Career College Programs.” U.S. Department of Education. October 30, 2014. <http://www.ed.gov/news/press-releases/obama-administration-announces-final-rules-protect-students-poor-performing-career-college-programs>

- 9.** “APSCU Files Suit Against Anti-Student Gainful Employment Regulation.” Career Education Colleges and Universities. Accessed on December 22, 2016. Available at: <http://www.career.org/news/apscu-files-suit-against-anti-student-gainful-employment-regulation>
- 10.** Association of Private Sector Colleges and Universities vs. Arne Duncan, in his Official Capacity as Secretary of the Department of Education. 1:14-cv-01870. Filed November 6, 2014. See also Association of Private Sector Colleges and Universities vs. Arne Duncan, in his Official Capacity as Secretary of the Department of Education 1’11-cv-01314. July 20, 2011. Available at: [http://www.huffingtonpost.com/davidhalperin/entitled-for-profit-colle\\_b\\_6123824.html](http://www.huffingtonpost.com/davidhalperin/entitled-for-profit-colle_b_6123824.html)
- 11.** Association of Private Sector Colleges and Universities, Appellant v. Arne Duncan, in his Official Capacity as Secretary of the Department of Education. Civil Action 11-1314 (RC). June 30, 2012. Available at: <http://www.pbs.org/wgbh/frontline/article/judge-blocks-key-provision-of-gainful-employment-rules/>
- 12.** Ibid.
- 13.** Association of Private Sector Colleges and Universities, Appellant v. Arne Duncan, in his Official Capacity as Secretary of the Department of Education. No. 1:14-cv-01870. March 8, 2016. Available at: <http://www.chronicle.com/blogs/ticker/federal-court-upholds-gainful-employment-rule-dealing-for-profit-group-another-loss/109294>.
- 14.** United States, U.S. Department of Education. *Federal Register*, October 31, 2014, pp. 65081. The net budget impact of the regulations are estimates over the FY 2014 to FY 2024 budget window.