Student Aid Policy Analysis

Summary and Analysis of Gainful Employment Final Rule

Mark Kantrowitz

Publisher of Fastweb.com and FinAid.org

June 2, 2011[1]

The gainful employment final rule[2] demonstrates significant movement from the original proposals published in the Notice of Proposed Rulemaking (NPRM) on July 26, 2010.[3] These changes provide colleges with an opportunity to comply with the regulations by giving them time to improve their performance and student success. The changes also address the most significant problems with the original NPRM and make it somewhat easier for programs to satisfy the gainful employment standards. The final rule implements a reasonable, thoughtful and responsive approach to implementing affordable debt restrictions on the programs that are currently subject to the gainful employment requirement.[4]

The most significant changes in the final rule are as follows:

- **Programs in the former yellow "restricted zone" become fully eligible.** Instead of maintaining two sets of thresholds for each of the three metrics, the final rule bases full eligibility on the less strict of each set of thresholds. A program may be fully eligible if it has a loan repayment rate of 35% or more (as opposed to 45%), a debt-service-to-income ratio of 12% or less (as opposed to 8% or less), or a debt-service-to-discretionary-income ratio of 30% or less (as opposed to 20% or less).[5] Effectively this reclassifies programs in the restricted zone as fully eligible, increasing the debt to income thresholds by 50%. There will be no enrollment growth restrictions.

- **Loan repayment rates based on P+I instead of P.** The loan repayment rate will be based on declines in the loan balance (principal plus interest) and not just the principal balance as proposed in the NPRM. This addresses the persistence of interest issue, giving programs more immediate credit for shifting borrowers from deferments and forbearances into active repayment.[6]

---

[1] This report is based on the PowerPoint presentation and press release distributed by the US Department of Education on June 1, 2011 and a briefing by a senior US Department of Education official. Due to the rushed nature of this report, there may be errors which will be corrected in a subsequent update. It will be updated if necessary after publication of the final rule as time permits.

[2] www.ed.gov/news/press-releases/gainful-employment-regulations

[3] Federal Register 75(142):43616-43708, July 26, 2010.

[4] The gainful employment regulations do not currently apply to Associate's degree, Bachelor's degree and more advanced degree programs at public and non-profit colleges. The regulations do apply to Certificate programs at public and non-profit colleges and to almost all programs at for-profit colleges.

[5] The debt-service-to-income and debt-service-to-discretionary-income ratios will be based on average earnings data from the Social Security Administration. The use of the word "income" in these ratios should be interpreted as referring to earnings.

[6] Mark Kantrowitz, *The Impact of 'Persistence of Interest' on Loan Repayment Rates*, August 23, 2010. www.finaid.org/educators/20100823persistenceofinterest.pdf

- **There will be no immediate loss of eligibility.** Instead, programs will lose eligibility if they strike out (fail to pass at least one of the three metrics) for three out of four consecutive fiscal years. Programs that lose eligibility will be ineligible for at least three years before they can regain eligibility. Programs with one strike will be required to make certain additional disclosures to prospective students and establish a three-day waiting period before students can enroll.[7] Programs with two strikes out of three years have additional disclosure requirements. This also effectively phases in the new regulations, since the soonest a program could lose eligibility is with the FY2014 metrics which will be published in early 2015.

- **Borrowing for living expenses will be excluded.** The debt figures for the debt-service-to-income and debt-service-to-discretionary-income ratios will exclude borrowing for living expenses. The debt figures will include tuition and fees but not room and board or other living expenses.[8]

- **Monthly loan payments for the debt-service-to-income and debt-service-to-discretionary-income ratios will be based on different repayment terms depending on degree program.** Certificate and Associate's degree programs will remain with a 10-year repayment term. Bachelor's and Master's degree programs will be based on a 15-year repayment term. Graduate and professional degree programs will be based on a 20-year repayment term. Changing the repayment term is the equivalent of changing the debt-service-to-income thresholds.[9] Using a 15-year repayment term with a 12% debt-service-to-income ratio is the equivalent of a 15.6% debt-service-to-income ratio with a 10-year repayment term. Using a 20-year repayment term with a 12% debt-service-to-income ratio is the equivalent of a 19.0% debt-service-to-income ratio with a 10-year repayment term.

ADDITIONAL NOTEWORTHY CHANGES

- **The US Department of Education may choose to disclose loan repayment rates and the debt-service-to-income and debt-service-to-discretionary-income ratios in order to help students compare programs.** The US Department of Education has not yet decided whether these and other indicators will be disclosed through College Navigator or some other tool.

- **The loan repayment rate and the debt-service-to-income and debt-service-to-discretionary-income ratios will be based on borrowers in their third and fourth years of repayment, excluding borrowers in their first and second years of repayment.** This will accommodate programs where there is a delay until borrowers get their full salaries after graduation, such as certain Bachelor's degree programs and law school graduates who clerk for a year or two. It also addresses concerns about the impact of a recession on loan repayment rates, when college graduates may have greater difficulty finding jobs. Loan repayment rates and the debt-to-earnings

---

[7] All programs are required to disclose total program costs, graduation rates, job placement rates, loan repayment rates, debt ratios and other indicators to students even if the program is fully eligible.
[8] Mark Kantrowitz, *Borrowing in Excess of Institutional Charges*, April 28, 2011. www.finaid.org/educators/20110428debtbeyondtuition.pdf
[9] See page 3 of Mark Kantrowitz, *Addendum to "What is Gainful Employment? What is Affordable Debt?",* April 27, 2010. www.finaid.org/educators/20100427gainfulemploymentaddendum.pdf

ratios for medical and dental programs will be based on borrowers in their sixth and seventh years of repayment, to accommodate routine deferments during internships and residencies.

- **Exception for small programs.** There will also be an exception for small programs with less than 30 borrowers in their third and fourth years of repayments. Borrowers in their fifth and sixth years of repayment will be included. If there are still less than 30 borrowers, the program will be considered as having a passing loan repayment rate.

- **Minimal retroactivity.** The FY2014 repayment rates and CY2013 debt-service ratios will be based on the FY2010 and FY2011 cohorts of borrowers, except for programs with less than 30 borrowers in this period and medical and dental programs.

- **Loan repayment rates will count interest only and negatively amortized repayment plans as making payments, within limits.** Nationally, 1.1% of borrowers (by loan balance) are negatively-amortized or interest-only within the income-based repayment, income-contingent repayment or graduated repayment plans.[10] Up to 3% of a program's loan balance may be in these repayment plans and counted in the numerator of the loan repayment rate. Borrowers in public service loan forgiveness will continue to be counted in the numerator of the loan repayment rate.

- **Income will be based on earnings according to data obtained from the Social Security Administration (SSA).** Actual earnings from alternate sources will be accepted, provided that the source meets strict standards for reliability. During a three-year transition period only (for the FY2012, FY2013 and FY2014 calculations), colleges may submit analyses based on Bureau of Labor Statistics data.

- **Accommodation for rapid improvement.** During the three-year transition period (for the FY2012, FY2013 and FY2014 calculations), loan repayment rates may be based on borrowers in the first and second years of repayment if they have better loan repayment rates than borrowers in the third and fourth years of repayment.

- **First year cap on eligibility losses.** Similar to the proposal that was included in the NPRM, eligibility losses during the first year (FY2014) will be capped at 5% of programs for each type of college (public, non-profit and for-profit).

RULE OF THUMB FOR CALCULATING MINIMUM SALARY

A good rule of thumb is that under a 12% debt-service-to-income threshold, multiplying the monthly loan payment by 100 yields the minimum annual salary necessary to repay the debt within this threshold. For example, a $500 monthly loan payment would require annual salary of $50,000 or more.

The debt-service-to-discretionary-income ratio will permit a higher median debt level than the debt-service-to-income ratio for borrowers with income above a particular threshold, around 250% of the

[10] Mark Kantrowitz, *Interest-Only and Negatively Amortized Loan Repayment Plans*, November 2, 2010. www.finaid.org/educators/20101102interestonlyrepayment.pdf

poverty line.[11] This involves multiplying the monthly loan payment by less than 100 to obtain the minimum annual salary necessary to repay the debt.

IMPACT OF FINAL RULE

A much smaller percentage of programs would be subject to warning disclosures under the final rule, and a much smaller percentage of programs would lose eligibility.

College Type	Fail Once	Fail Three Times
Total	8%	2%
Public	3%	1%
Non-Profit	5%	1%
For-Profit	18%	5%

The elimination of the yellow restricted zone and the specification of repayment terms based on degree program appear to benefit more-advanced degree programs to a greater extent than less-advanced degree programs. Based on Missouri data, for example, 47.9% of Bachelor's degree programs, 35.4% of Associate's degree programs and 20.3% of Certificate programs would have been restricted, so there is a greater improvement in eligibility for the Bachelor's degree programs. Nevertheless, a greater percentage of Associate's degree programs will be ineligible if one assumes a net impact consistent with the Missouri data, since 21.7% of Bachelor's degree programs, 38.0% of Associate's degree programs and 15.9% of Certificate programs at for-profit colleges would be ineligible at the 12%/30%/35% thresholds based on the Missouri data. The actual percentages by degree program will be lower than these figures given all the other changes in the final rule, but it is not possible to determine the impact of the other accommodations in the final rule using the Missouri data. However, it seems likely that for-profit colleges may try to address some at-risk Associate's degree programs by compressing them into Certificate programs, since this will reduce the debt associated with these programs.

[11] The 2011 HHS Poverty Guidelines are $10,890 for a family of one, per http://aspe.hhs.gov/poverty/. 250% of this figure is $27,225.