Regulating Too-Big-to-Fail Education

Next Steps for the Department of Education

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About the Report

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Introduction

This report is the third in a series, collectively titled Regulating *Too-Big-to-Fail Education*, discussing the current crisis in Department of Education oversight of for-profit higher education. The first report, *A Review of the For-Profit College Industry*, assessed the Department's current practices and proposed new early-warning indicators for evaluating institutions' financial soundness.[1] The second, *A Snapshot of Five For-Profit Colleges*, revealed the financial turmoil that currently threatens five of the country's largest publicly traded for-profit college chains.[2]

Last week the Department of Education released its proposals for a series of new rules on issues on facing students today, including a new financial responsibility rule for at-risk higher education institutions. This new rule, if it is implemented on schedule next July, will be a real step forward in ensuring that for-profit colleges conduct themselves responsibly, but on its own it does not go far enough quickly enough. As the collapse of Corinthian Colleges last year demonstrated, the current regulatory system for for-profit colleges is broken, leaving students vulnerable to predatory practices and taxpayers on the hook for billions, even tens of billions, of dollars in potential liabilities .[A] The next major for-profit college collapse may already be on the horizon, and its magnitude could easily dwarf that of the Corinthian disaster.

In the pages that follow, we will lay out proposals for six specific regulations—many of which could be implemented in some form currently through provisional program participation agreements, and others which should be incorporated into the Department's final financial responsibility rule—that would dramatically strengthen the Department's capacity to intervene to protect students' and taxpayers' interests in relation to institutions at risk. The need for such intervention is urgent, and the time for the Department to act is now.

Prologue: The Corinthian Collapse

The collapse of Corinthian Colleges, one of the nation's largest for-profit higher education companies, is an object lesson in the failures of the current regulatory system.

In 2014 Corinthian Colleges, long notorious for deceptive and predatory practices, was under investigation by multiple federal and state agencies. And yet Title IV federal financial aid—grants and student loans underwritten by the U.S. taxpayer—were still flowing into the corporation at a rate of more than a hundred million dollars a month.

On June 12 of that year the Department of Education, citing Corinthian's failure to comply with its previous requests for documents and data, announced that future financial aid payments to the company would be held for three weeks before disbursement. Not eliminated. Not restricted. Just delayed for twenty-one days.

[A] Taken together, the Department estimates that the proposed rules will eventually cost the government somewhere between $1.997 billion and $42.698 billion for loans originated between 2017 and 2026.[3]

Like most for-profit colleges, Corinthian was utterly dependent on federal funding for revenue, and so this mild sanction, intended to prod the teetering company toward compliance, instead triggered its collapse. Corinthian quickly declared that in light of its precarious financial position, a twenty-one-day delay in access to federal financial aid would be a death sentence.

A precipitous implosion of the company would have left its 72,000 students stranded—and, not incidentally, eligible to have their debt canceled at taxpayer expense. Scrambling to protect those students, the Department crafted an agreement with Corinthian that provided it with an additional $35 million in student aid money. In exchange, Corinthian agreed to sell off or close its campuses in an orderly way.

That November, in a deal brokered by the Department, Corinthian sold fifty-six of its campuses to one of the Department's contracted debt collectors—a company that had no experience running higher education institutions. The following April, after five more months of turmoil, Corinthian declared defeat, closed its remaining campuses, and abandoned its remaining 16,000 students. In a statement, the company blamed this final betrayal on "federal and state regulators seeking to impose financial penalties and conditions on buyers and teach-out partners."[4]

Days after Corinthian shuttered its last campuses, bringing the biggest institutional collapse in U.S. higher education history to a close, the Department set to work responding to the situation it had been so bent on preventing. Even at that late date, it was unprepared for the scope of the task. Though it deployed staff "to as many campuses as possible to talk directly with students,"[5] there was no way those few staffers could meet with all those Corinthian had harmed—the scale of the crisis simply overwhelmed the Department's capacity to respond.

Today, more than a year after Corinthian closed its doors, the Department continues to struggle with its aftermath. According to the most recent report issued by Special Master Joseph Smith, as of March 2016 only 8,886 of the students who were defrauded by Corinthian or abandoned in the company's collapse had received debt cancellation, in an amount totaling just over $132 million.[6] Nearly nine thousand borrower defense claims remained open.

How did federal oversight of Corinthian Colleges go so badly wrong? Why did the company continue to receive a taxpayer subsidy amounting to more than a billion dollars a year even after its bad practices were common knowledge? Why did the Department not take steps to compel Corinthian to change its ways while reform was still possible, or to protect students and taxpayers against the possibility of collapse? And why, even after the dissolution of the company became inevitable, did the Department find itself coerced into providing Corinthian with continuing financial support?

The answer to all these questions lies in the Department's failure to take effective, proactive steps to hold Corinthian accountable at a time when accountability could still have had a positive impact. While Corinthian's financial mismanagement and predatory tactics had been a matter of record for years, the Department's response was muted and tentative. Though the Department possessed, for instance, the ability to require Corinthian to post a letter of credit—an enforceable agreement to cover costs to the taxpayer that might arise out of its mismanagement and malfeasance—it never did so. And as the Department hesitated, the company fought threatened sanctions aggressively, with corporate lawyers telling a California court in 2014 that it shouldn't take action against the company in part because doing so would force colleges to shut down, triggering a potential $1.2 billion bill for taxpayers stemming from closed-school discharges.

Having failed to exercise effective oversight over Corinthian before 2014, the Department was left with no palatable options when the full scale of the crisis became apparent. In the absence of an effective, forward-thinking regulatory system, the Department found itself propping up Corinthian in an increasingly desperate attempt to keep it from self-destructing—and then cleaning up the company's mess when it did.

Missed Opportunities in Negotiated Rulemaking

As Negotiated Rulemaking for Higher Education 2015–2016[7] began in August 2015, a key concern in the higher education community—and a topic at the front of everyone's mind—was how the Department could better protect students and taxpayers from predatory, insolvent, and incompetently-run colleges and universities.

The participants in negotiated rulemaking devoted considerable energy to the ongoing challenges posed by the Corinthian implosion—providing debt relief to the tens of thousands of students who had been materially harmed by Corinthian and covering the cost of cancelling the hundreds of millions, if not billions, of dollars in active student debt that had been issued to the school.[A] At the same time, negotiators were acutely sensitive to the risks posed by future potential Corinthians, and to the need to find robust new regulatory mechanisms to prevent similar disasters going forward.

Mindful of that second question, the Department asked negotiators to propose steps it could take to protect students and taxpayers from failing colleges. Specifically, it tasked them with determining which events should be considered as triggers for heightened Department scrutiny of at-risk colleges; what consequences colleges should be subject to if they were found to be not financially responsible; and how, when the Department demanded that a college post a letter of credit, the scale of the set-aside should be determined.[8] (A letter of credit effectively serves as collateral for the Department, limiting students' and taxpayers' exposure in the event of institutional failure.)

[A] The Department has estimated that if all 350,000 Corinthian students over the last five years applied for and received debt relief, that cost alone could be as much as $3.5 billion.

These were the right questions to ask, but astonishingly the Department made it impossible for negotiators to provide sound answers.

As early as the first rulemaking session, negotiators had asked the Department to provide a list of schools that had posted letters of credit. The Department refused, claiming that no such list existed. This refusal hobbled negotiators' ability to draft new regulations throughout the process, forcing them to work in ignorance as to the scope of the instability problem and the Department's present approach to redressing it.

Late in the afternoon of March 17, 2016, during the negotiators' second-to-last meeting ever, the Department finally provided the group with a partial response to their request—a one-page summary of letter of credit statistics for for-profit and non-profit colleges.[9] But that document did not identify which specific colleges had been required to post letters of credit, how much they had posted, or even the sorts of aggregate data that would have allowed negotiators to assess the Department's priorities and strategy. At the time, officials representing the Department continued to insist that no such information was available.

Early the following morning, however, the higher education journal *Inside Higher Ed* published an in-depth report based on the very data that the Department had refused to provide to the negotiators.[10] Obtained through a Freedom of Information Act request filed months earlier, the material published by *Inside Higher Ed* included a complete list of schools posting letters of credit between January 1 and November 17, 2015, the precise dollar amount for each institution's letter, the percentage of the institution's Title IV funds it represented, the length of time that the letters would be required, the names of the banks providing the letters of credit, and other essential information.

Throughout the three sessions of negotiated rulemaking, real progress had been made in addressing how the Department could determine institutional financial responsibility and limit liabilities stemming from bad actors, but with crucial information withheld from them until the literal final hours of their work, negotiators were ultimately unable to reach consensus on new financial responsibility regulations. As a result, the Department's rule was crafted without full and informed input from the negotiators, and its proposals reflect that absence.

The Gatekeepers of Billions of Taxpayer Dollars

The Department provides roughly $130 billion in Title IV funding to colleges and universities every year. For institutions of all types, Title IV money—in the form of grants, federal student loans, and work-study funding—is what allows students who otherwise could not afford college the opportunity to attend, and what allows the institutions themselves to serve students. In a very real sense, Title IV is the lifeblood of American higher education.

Title IV revenue is particularly essential to for-profit colleges, which in many cases draw nearly all of their funding from Title IV. Such colleges often establish tuition rates pegged to aid ceilings and almost exclusively enroll students who bring such aid with them. Such targeting is so common, in fact, that since 1998 federal law has set a cap of 90% on the revenue that for-profit colleges can receive from Title IV financial aid, a cap that many such schools—Corinthian, until its collapse, among them—never deviate far from. For-profit colleges that lose access to Title IV funding rarely survive more than a few weeks without it before declaring bankruptcy.

Oversight of Title IV is thus a critical function of the Department of Education. Before receiving Title IV funding, a college must be certified as eligible by the Department, and in order to grant such certification the Department requires the school to demonstrate that it is institutionally sound. It does so by establishing various requirements—the college must be approved by a state authority, accredited by a recognized accreditor[A], and in compliance with government standards relating to loan default rates, revenue, and gainful employment by former students. In addition, institutions must meet specific financial benchmarks—passing the Department's financial responsibility test, keeping current on debt payments, certifying the ability of the school and individuals running it to administer Title IV funding, and otherwise demonstrating financial health.

These standards are not arduous to meet, and in fact the Department recognizes that they are at present too easily subverted. Corinthian Colleges, notoriously, managed to consistently meet the Department's benchmarks even after its bad practices and financial frailty had become public knowledge. Throughout the entire multi-year arc of Corinthian's investigation, exposure, and ultimate collapse, the company was never declared to be not financially responsible, never required to submit even a 10% letter of credit to the Department.

As the Department itself now describes it,

> **With Corinthian, . . . the Department ended up with no financial protection for either closed school or borrower defense claims. . . .**
>
> **Applying the routine tests under current regulations did not result in financial protection, because Corinthian appeared at the time it provided the Department with its audited financial statements to pass those tests. Only later—too late to secure financial protection—did further investigation reveal that Corinthian in fact had failed the financial tests in current regulations.** [11]

Corinthian had good reason to lie to the Department. If a college fails to demonstrate that it is financially responsible, it risks being denied access to Title IV funding completely.

[A] As noted by Ben Miller in *ACICS Must Go*: "One common misconception about accreditation agencies is that if one were derecognized, every institution it approves automatically loses access to federal financial aid. This is incorrect. Federal law states that an institution whose accreditor loses recognition becomes provisionally certified. This allows the college to still receive federal financial aid. And this provisional certification lasts for eighteen months from the date that the U.S. Department of Education terminates an accreditation agency's recognition."

In practice, that rarely happens—only a handful of colleges a year are rejected for or terminated from Title IV funding. A far more common response is for an institution to be required submit a letter of credit to the Department.

A letter of credit is collateral that serves as an assurance of an institution's ability to pay money it may in the future owe to the government. These letters are drawn upon if the institution misleads or deceives students into enrolling that enable them to become eligible to have their debt cancelled through borrower defense, or to cover the cost of loan cancellation, teach-out plans, and institutional obligations to the Department if the institution closes its doors. Letters of credit thus protect the taxpayer from having to pay the costs associated with institutional failure.

Most schools required to submit a letter of credit to turn to banks for financing. As of November 17, 2015, the "Big Four" banks—JPMorgan, Bank of America, Wells Fargo, and Citibank—were backing more than $485 million in letters of credit nearly exclusively for for-profits, more than half of the total amount currently outstanding, with smaller banks backing most of the remainder. (Schools that are unable to get a bank to finance a letter of credit on their behalf, or which prefer to not pay the associated fees, have the option to provide cash collateral by placing the required amount into a Department escrow account, although this option is rarely used.)

The standard letter of credit requirement for an institution failing to demonstrate financial responsibility is 50% of the previous year's Title IV funding. The Department, however, has the right to waive that requirement, granting a college what's known as provisional certification at a lower rate.

Under provisional certification, the institution is subject to stricter-than-usual oversight and reporting requirements and submits a letter of credit at a percentage set by the Secretary. To quote *Regulating Too-Big-to-Fail Education: A Snapshot of Five For-Profit Colleges*:

> **When the Secretary requires such a letter of credit, the amount provided as collateral may range from as little as 10% of the most recent year's financial aid allocation to as much as 100%. Like a judge determining a bail amount, this gives the Secretary an opportunity to consider the seriousness of the alleged actions and the past record of these schools.**
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> **In theory, this gives the Department the regulatory power to ensure that federal taxpayer funds aren't being used to enrich investors and executives while leaving students with nothing to show for their months or years of hard work but a monthly bill they cannot possibly afford to pay.**[12]

Title IV funding, as noted above, puts billions of dollars into the hands of students and colleges every year, and it is the Department's obligation to keep that money out of the hands of predatory and precarious institutions. Financial responsibility rules and their accompanying letter of credit requirements are thus an essential component of the Department's work.

As it stands now, that work is being carried out haphazardly and incompletely.

The Failure of Regulation at the Department of Education

The Department's certification process is supposed to weed out failing colleges from the Title IV program while providing troubled but viable institutions with opportunity and incentive to meet the Department's standards and deterring misconduct by others. In practice, the process is performing none of those functions.

As noted in the previous section, current regulations allow too many mismanaged for-profit colleges to escape warranted enforcement by the Department entirely. But even when institutions fail to meet the Department's clear standards, its regulatory response is generally weak and slow, particularly with regard to the largest, and thus most potentially dangerous, for-profit colleges.

With the release of comprehensive letter of credit data by *Inside Higher Ed*, a fully-informed discussion of the strengths and weaknesses of current Department policy is now possible for the first time. Our review of that data reveals a Department that has effectively declared the largest for-profit colleges not only too big to fail but too big to regulate as well, leaving students and taxpayers to clean up the messes of an industry plagued with financial woes.

The 50% letter of credit requirement, which is supposed to be the standard response to failure to meet Department standards, is rarely imposed. Of the 421 institutions required to post a letter of credit in the *Inside Higher Ed* dataset, only 71 were posting at or above 50%, meaning that the remaining 350 institutions that had failed to demonstrate financial responsibility were operating under provisional certification. Provisional certification is supposed to be a rarity—in the Department's words, "an alternative that the Department may choose to offer in exceptional circumstances."[13] It has, instead, become the norm.

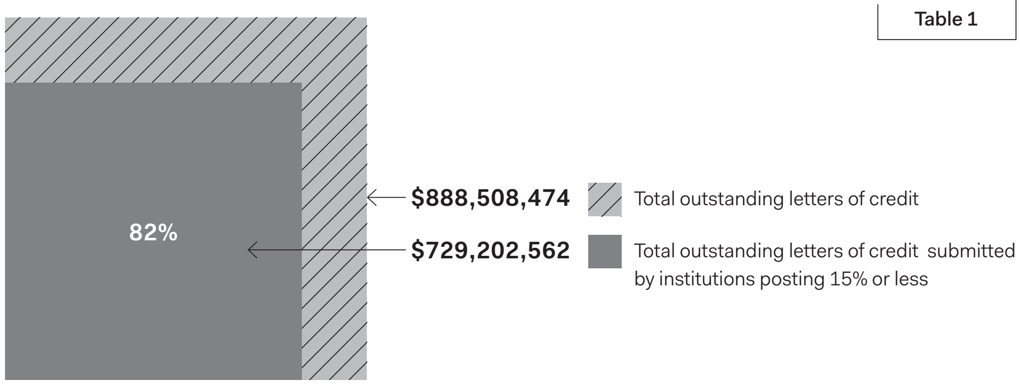
A crucial question for any institution operating under provisional certification is how substantial of a letter of credit it will have to submit. Even if the institution isn't forced to put up the collateral itself, letters of credit are expensive—and the bigger they are, the more expensive they are. Requiring a letter of credit at a high rate is thus a powerful incentive to comply with good practices. Set too high, on the other hand, a letter of credit requirement could destroy an already fragile institution, leaving students and taxpayers with no prospect of recompense. It is thus essential that letter of credit requirements be imposed both robustly enough to have an impact and early enough to influence colleges before they are too weakened to withstand sanctions. In principle, provisional certification gives the Department wide discretion in tailoring letters of credit to properly redress the failings of at-risk institutions. But the Department has rarely used that discretion to take aggressive, timely action.

While 10% is supposed to be the floor for a provisional certification letter of credit, that floor has become the ceiling for too many institutions. Of 421 institutions posting a letter of credit in the *Inside Higher Ed* data, two fifths—168—were posted at 10% or less, and 83% were at 25% or below.[14]

In addition, the Department often extends provisional certification under such low-rate letters of credit on a long-term basis. Provisional certification may be granted to an institution for an initial period of up to three years, and if it still hasn't become financially responsible by that time, the Secretary may extend provisional certification further. (The *Inside Higher Ed* data include institutions under provisional certification for terms as long as five years.)

And who are the institutions that the Department is allowing to violate its own standards for financial stability for years without significant penalty? As the Department's own figures clearly demonstrate, the institutions that pose the greatest threat to students and taxpayers are precisely those to whom the Department shows the most deference.

Table 1



Two hundred and forty-seven institutions in the *Inside Higher Ed* data—just over half of the total—posted letters of credit of 15% or less. But while these letters were set at low rates, the institutions posting them were typically so large, and so dependent on Title IV money, that their letters represented an overwhelming 82% of the total dollar amount posted (Table 1, above). The largest and most dangerous institutions, in other words, have not just been deemed too big to fail—as shown by the Department's willingness to continue to provide them with a steady flow of Title IV funding even when they are in crisis—but too big to regulate (Appendix A). The Department has refused to impose a 50% letter of credit on any large for-profit college because it fears that such aggressive actions, even when warranted, would create a financial crisis that would cause them to fail.

The companies themselves understand and exploit this fear. When the Department considers imposing penalties many respond as Corinthian did in the early stages of its collapse—with barely veiled threats of school closures. During the sale of Apollo Education, which operated the University of Phoenix, the company stated in a corporate filing that the deal would be scuttled if the Department required its parent company "to post or maintain a letter of credit in excess of 10% of the Title IV Program funds received by UOPX in its prior fiscal year," as such limitations would constitute a **"Burdensome Condition"** (double emphasis in original).[15]

Similarly, in a recent corporate filing, ITT Technical Institute declared that "any significant delay in our institutions' receipt of Title IV Program funds due to the penalties that the ED has imposed on us … could negatively impact our ability to satisfy our payment obligations under contractual arrangements. … Depending on the length of the delay," it continued, "we cannot assure you that we would be able to continue to operate our business in such an event."[16]

In the event of such a failure, of course, the American taxpayer would once again be left to pick up the pieces.

Because the Department remains paralyzed by fear that any action it takes will cause an institution to fail precipitously and uncontrolledly, these too-big-to-fail institutions continue to dictate the terms by which the Department regulates them. There is thus currently little incentive for institutions to address the deficiencies that prevent them from obtaining full certification. Letters of credit become a readily-absorbed cost of doing business rather than an effective spur to needed reform, while lengthy provisional certification agreements effectively shield institutions from further sanction while depriving them of incentives to improve their practices. Rather than incentivizing companies to correct internal problems before they develop into crises, provisional certification serves, in practice, to shield them from the consequences of their bad acts.

As a consequence of this systemic laxity, institutions that the Department has identified as failing to meet standards for financial responsibility are being allowed to remain on the course that brought them to the point of crisis with minimal sanctions even as they continue to receive Title IV funding amounting to billions of dollars. The dangers their practices pose to students go unchecked, and the accompanying financial risk continues to fall on taxpayers, not the institutions themselves.

In such a regulatory environment future Corinthians are not merely likely, but inevitable. It is imperative that the Department take action to remedy this culture of impunity.

The Biggest of the Big

While at-risk institutions tend to be subjected to Department oversight in an inverse relationship to their size at all levels, an examination of the very largest institutions listed in the Inside Higher Ed report—the biggest of the big—throws the Department's "too big to regulate" philosophy into sharp relief.

Last year, twenty of the institutions identified as financially troubled by the Department, sixteen of them for-profits, received more than $60 million apiece in Title IV financial aid funds. Due to their size, these institutions pose risks of huge liabilities to the Department and disruption to students' lives should they fail. Yet the Department's sanctions against these powerful institutions are uniformly minimal—of the twenty institutions receiving more than $60 million in Title IV funds that were required to post a letter of credit, only one was required to post more than the minimal 10–15% (Table 2, next page).

Table 2: *Institutions Posting Letters of Credit Receiving More than $60 Million in Title IV Funding*

Institution Name	Reason	Type	Amount (% of Title IV)	Title IV Received
Walden University	Failed Numeric Test	For-profit	$82,989,830 (10%)	$829,898,300.00
ITT Technical Institute	Failed Past Performance Requirements	For-profit	$78,884,021 (10%)	$788,840,210.00
Argosy University	Failed Past Performance Requirements	For-profit	$84,571,511 (15%)	$563,810,073.33
South University	Failed Past Performance Requirements	For-profit	$47,536,064 (15%)	$316,907,093.33
Art Institute of Phoenix (The)	Failed Past Performance Requirements	For-profit	$46,392,421 (15%)	$309,282,806.67
Virginia College	Failed Past Performance Requirements	For-profit	$26,548,437 (10%)	$265,484,370.00
Keiser University	Failed Numeric Test	Private, Non-profit	$24,522,691 (10%)	$245,226,910.00
Art Institute of Pittsburgh (The)	Failed Past Performance Requirements	For-profit	$28,630,773 (15%)	$190,871,820.00
Miller-Motte Technical College	Failed Numeric Test	For-profit	$15,695,190 (15%)	$104,634,600.00
Northcentral University	Failed Numeric Test	For-profit	$10,196,959 (10%)	$101,969,590.00
Art Institute of Atlanta (The)	Failed Past Performance Requirements	For-profit	$15,219,750 (15%)	$101,465,000.00
Remington College	Failed Numeric Test	Private, Non-profit	$9,343,607 (10%)	$93,436,070.00
Vatterott College	Failed Past Performance Requirements	For-profit	$8,449,096 (10%)	$84,490,960.00
Alliant International University	New Owner Missing 2 yrs of Audited Financial Statement	Private, Non-profit	$19,653,781 (25%)	$78,615,124.00
Illinois Institute of Art (The)	Failed Past Performance Requirements	For-profit	$11,635,178 (15%)	$77,567,853.33
McCann School of Business & Technology	Failed Numeric Test	For-profit	$11,263,447 (15%)	$75,089,646.67
Instituto de Banca y Comercio	Failed Past Performance Requirements	For-profit	$11,047,470 (15%)	$73,649,800.00
Florida Career College	Failed Numeric Test	For-profit	$7,304,200 (10%)	$73,042,000.00
Thomas Jefferson School of Law	Failed Numeric Test	Private, Non-profit	$6,741,866 (10%)	$67,418,660.00
National University College	Failed Past Performance Requirements	For-profit	$9,728,444 (15%)	$64,856,293.33

What Can Be Done

As damning as the *Inside Higher Ed* data are, they thus exclude all those higher education institutions that, although engaged in bad behavior or bedeviled by mismanagement, have like Corinthian navigated the process cannily enough to be deemed "financially responsible."

Action is already underway to address this regulatory deficiency. During negotiated rulemaking negotiators and the Department identified a number of ways to enhance Department oversight of such institutions—new benchmarks for good behavior that, if violated by an institution, would each trigger a mandatory 10% letter of credit requirement.

These proposed triggers, which include such events as lawsuits by state or federal governments, adverse acts by accrediting agencies, and high rates of loan defaults, would make it significantly harder for future Corinthians to evade accountability in the long run-up to disaster.[17] Finalizing and enacting them will be an important step forward, and the Department must take that step. Important as it is, however, it represents only a partial and belated response to the crisis.

Six Ways to End the Era of Too Big to Regulate at the Department of Education

The lessons of Corinthian and the *Inside Higher Ed* data are clear. The Department's regulation of at-risk institutions must be reoriented around two straightforward objectives: Early intervention to head off institutional failure before it becomes inevitable, and rigorous defense of students' and taxpayers' interests both before and after the point of crisis. Essential to both of these objectives is a degree of institutional accountability that does not currently exist.

In the pages that follow, we propose six specific reforms to the Department's oversight structure, extending the discussion begun during rulemaking and complementing the negotiators' proposals. Nearly all of what we propose could be implemented by the Secretary immediately under existing authority, and should be formally adopted as part of finalized rulemaking in November 2016 as well. Incorporating these provisions uniformly for the institutions currently deemed "too big to regulate" would save taxpayers millions, even billions, of dollars while incentivizing at-risk institutions to implement necessary reforms before the point of crisis.

Limit Provisional Certification

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The most pressing need in the regulatory landscape is controls on the use of provisional certification, a status that the Department currently extends in situations that go far beyond the "exceptional circumstances" contemplated in existing regulations.

An appropriate first step toward curbing provisional certification would be the closure of the loophole that allows the Department to extend that status beyond the standard three years. If a school hasn't become financially responsible after three years, the Department should either terminate their provisional certification, mandating the submission of a letter of credit of 50% in addition to any percentage accruing from automatic triggering events, or revoke their access to Title IV funding entirely.

Limiting the time for which schools can be provisionally certified would incentivize them to take steps to improve to their financial management immediately, rather than allowing them to spend years in limbo, avoiding serious accountability while continuing business as usual.

Establish Sensible Enforcement Mandates

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The Department's proposal to create a list of events that would automatically trigger independent 10% letter of credit requirements, mentioned at the start of this section, would be a significant step toward imposing accountability on troubled institutions.[A] The 10% figure envisioned for each triggering event, however, is arbitrary and in some cases insufficient.

While the proposed rule would empower the Secretary of Education to require more than the 10% minimum for a given triggering event, past experience gives little cause for confidence that this discretion would be exercised reliably, consistently, and appropriately. Instead, to better assess the severity of each category of institutional failure and the potential liability it poses to students and taxpayers, the Department should establish a working group composed of the U.S. Departments of Education and Treasury, the Consumer Financial Protection Bureau, the Federal Trade Commission, and state attorneys general.

Given the important roles and perspectives each of these federal agencies has, and the vital role that states continue to play in regulating for-profit colleges, these entities are collectively well-suited to advise the Secretary on whether an event's 10% automatic trigger accurately reflects the risks that accompany it or whether an additional percentage should be added to the required letter of credit. The working group could also provide guidance as to whether additional actions—such as emergency fines, fines, or termination of an institutions provisional certification—should be imposed.

Restrict Institutional Spending

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When an institution has failed to demonstrate financial responsibility, the Department should impose immediate constraints on the institution's freedom to use Title IV funding to subsidize executive compensation, dividends and stock buybacks, and marketing. The first priority of an at-risk institution should be strengthening its own financial well-being and improving the service it provides to its students.

Education Management Corporation lost $664 million dollars in 2014—with more than six hundred employees laid off. But CEO Edward West and CFO Mick Beekhuizen, however, each earned steep bonuses that year—despite those losses and the fact that the company had already been deemed not financially responsible.[18] Both would leave the company by January 2016, following numerous investigations into company practices. (In dollar terms, Education Management Corporation's letter of credit was the largest in the Inside Higher Ed database for 2015.) It's important that the Department ensure Title IV funding is being used to improve the institution and the livelihood of its students during provisional certification—not to pay seven-figure salaries and bonuses.[19]

[A] The events and actions include former students filing borrower defense claims, state or federal agency actions, accrediting agency actions, failing to derive at least 10 percent of revenue from non-Title IV sources, having cohort default rates of 30 percent or greater for the two most recent years, failing to meet standards under the gainful employment rule, the Securities and Exchange Commission warning that it may suspend trading on the institution's stock, and the withdrawal of owner's equity (including declaring a dividend).

Apollo Education Group (University of Phoenix)	$7,336,755
Career Education Corporation	$9,173,230
DeVry Education Group	$5,343,407
Education Management Corporation	$3,524,864
ITT Educational Services	$1,379,345

Note: These figures represent Chief Executive Officer compensation for 2015, except for Education Management Corporation which represents 2014 (the last year the company publicly disclosed this information). Career Education Corporation reflects total CEO compensation for 2015, including former and interim officers.

When Corinthian was on the brink of collapse, the Department conditioned its final payments of Title IV funding to the company on the stipulation that those funds be spent only on educational expenses, but such restrictions have historically been rare.[A] The first priority of an institution found to be not financially responsible should be strengthening its own financial well-being and improving the service it provides to its students. Where executive compensation, dividends and stock buybacks, or other expenditures become incompatible with that objective, the Department should impose reasonable constraints on such spending.

A ban on dividends specifically would prevent unscrupulous actors from raiding company coffers before a collapse instead of directing funds to correcting the deficiencies that placed the institution in its precarious position. The Department is already proposing to establish such dividends as a trigger for a 10% letter of credit in institutions whose composite score falls below 1.5. We believe they should go further.

Prohibit Institutions from Establishing New Programs and Campuses

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For the duration of the period in which an institution or parent company is found to be failing to meet standards of financial responsibility, the Department should bar them from establishing new programs and campuses. A school that is struggling to manage the finances of its current campuses should not be permitted to use taxpayer money to expand.

By curbing the creation of new campuses or programs within institutions that face a demonstrated risk of closure, the Department would be protecting students from enrolling in programs with a high risk of failure as well as containing the risk to taxpayers if the institution does not improve.

[A] For example, Corinthian increased the amount it spent on marketing and recruiting, from $328 million in 2010 to $396 million in 2013, a jump of 20 percent. This condition prevented Corinthian from using Title IV funding to continue this exuberant spending.

Addressing the Role of Beneficial Owners

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When institutions are determined to be not financially responsible, the Department should require the persons or beneficial owners[A] that exercise substantial control over the school to submit the letter of credit needed to continue to receive Title IV funding.

This would prevent institutions in financially precarious situations from turning to large banks to fund letters of credit, which can cost millions every year that they must be provided. In 2012, when EDMC was required to post a letter totaling $50 million, the for-profit chain paid more than $4 million in fees to BNP in order to have them submit a letter on their behalf.[20] In December 2015, ITT Technical Institute opted out of its letter provided by JPMorgan Chase and instead provided a cash collateral to the Department's escrow account. In a corporate filing they estimated "savings to the Company of approximately $18.1 million between January 1, 2016 and November 4, 2019, that it otherwise would have been required to pay for fees."[21]

Once banks provide these letters, banks are then able to use their significant leverage to force institutions to restructure to limit the bank's liability in the event the school closes.[B] Conversely, requiring these parties to play an active role in the financial well-being of the institution would create an incentive to ensure the implementation of needed reforms.

Enacting this reform would require disclosure of an institution's beneficial owners at the time it entered provisional certification. Such disclosure would have the added benefit of allowing students and taxpayers to know whether provisionally certified institutions had long-term capital backing them or were backed by vulture funds. Identifying an at-risk institution's investors could contribute to a broader assessment of the financial stability of the institution, and allow the Department to develop warning indicators that better reflect investor behavior.

Calculate Letters of Credit Based on Actual Risk

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It has become clear that the Department's existing letter of credit rates are wholly insufficient to safeguard students' and taxpayers' interests in the event of institutional collapse. As noted at the start of this report, taken together, the Department estimates that the proposed rules will eventually cost the government somewhere between $1.997 billion and $42.698 billion for loans originated between 2017 and 2026. The bulk of these write-offs would come from the discharge of borrowers' loans through borrower defense and closed school discharges. A review of the federal data provided by Inside Higher Ed shows that the Department currently has less than $1 billion in letters of credit to cover these costs, potentially leaving tens of billions of dollars for taxpayers to cover.

[A] A beneficial owner is a person or institution that reaps the benefits of ownership while legal title is held elsewhere.

[B] Following the collapse of Corinthian, it is now common practice for banks to create conditions over institutions when they submit letters of credit on their behalf that will cause the school to be in violation of their agreement if the Department imposes any sanctions on the school. Such conditions, in turn, place pressure on the Department to avoid taking steps that deepen existing financial crises.[22]

After two decades of stratospheric growth, the for-profit college industry has experienced a steep decline in enrollment in recent years, and the resultant downturn in revenue has left many such institutions financially precarious. At the same time, the current process for calculating letter of credit obligations, under which such payments are pegged to an institution's most recent year's revenue, has little correlation with the cost of debt cancellation and leaves taxpayers with ever-diminishing protection against institutional failure as an institution shrinks.

In the event that a school is found to have deceived or misled students, it is not just the current year's students who are entitled to bring claims—former students are also able to file borrower defense discharge to have their debt canceled, an eventuality that the one-year letter of credit formula fails to contemplate. Similarly, in the event that an institution closes a campus and students apply for closed school discharge, it's all of their student debt cancelled—not just that of the previous year.

When institutions engage in systematic abuse over an extended period, as Corinthian did, letter of credit requirements tied to the most recent year's Title IV funding will inevitably fail to cover the cost of cancelling this debt. (In the case of Corinthian, thousands of former students holding Federal Family Education Loans—a category of loan that has not been issued since June 2010—have submitted borrower defense claims in recent months.) If the Department hopes to protect students and taxpayers, it must require letters of credit that more accurately reflect the expense of closed school discharges and borrower defense claims over multiple years of Title IV funding received.

Defining a Legacy: Ending Too Big to Fail, Too Big to Regulate at the Department of Education

The for-profit college industry that ballooned at the height of the Great Recession has reached a time of reckoning, facing rapidly declining enrollment rates and heightened scrutiny. Revenue has shrunk, share values are plummeting, and allegations of deception and predatory behavior have multiplied. The failure of Corinthian Colleges showed how woefully unprepared the Department was when it was time to respond, and that failure has had devastating effects on tens of thousands of lives.

The Department cannot afford to be caught flatfooted when the next Corinthian inevitably occurs. This requires early intervention to prevent continued institutional mismanagement, and the uncompromising defense of students' and taxpayers' interests once such mismanagement is identified. As outlined throughout the *Regulating Too-Big-to-Fail Education* series, there are immediate steps the Department can take, and even as it moves forward with new rules on financial responsibility it must make clear that the era of too big to fail, too big to regulate has come to an end—not when the new rules are implemented in 2017, but now.

By requiring for-profit colleges that are currently provisionally certified to adhere to higher standards to improve their financial well-being, the Department will shine much-needed sunlight on an industry that has escaped meaningful regulation for too many years. Doing so will improve outcomes across the for-profit sector, compelling the most deficient and recalcitrant institutions to either reform or leave the marketplace altogether.

The next few months will be critical ones for the meaningful regulation of the for-profit industry. As this report goes to press, the Accrediting Council for Independent Colleges and Schools (ACICS), the accreditor that certified Corinthian Colleges as fit to serve students until the very day that Corinthian declared bankruptcy, is being reviewed by the Department's National Advisory Committee on Institutional Quality and Integrity. If ACICS is derecognized and terminated as an accreditation agency, many of the largest for-profit chains—including giants such as Career Education Corporation, Education Management Corporation, ITT Technical Institute, Zenith Education Group (formerly Corinthian Colleges)—will automatically become provisionally certified and subject to the Department's enhanced oversight.

The Department itself recognizes that the current system is failing to protect students and taxpayers. If it does not seize the current opportunity to enact meaningful reform, the costs to the nation's students and taxpayers will be staggering.

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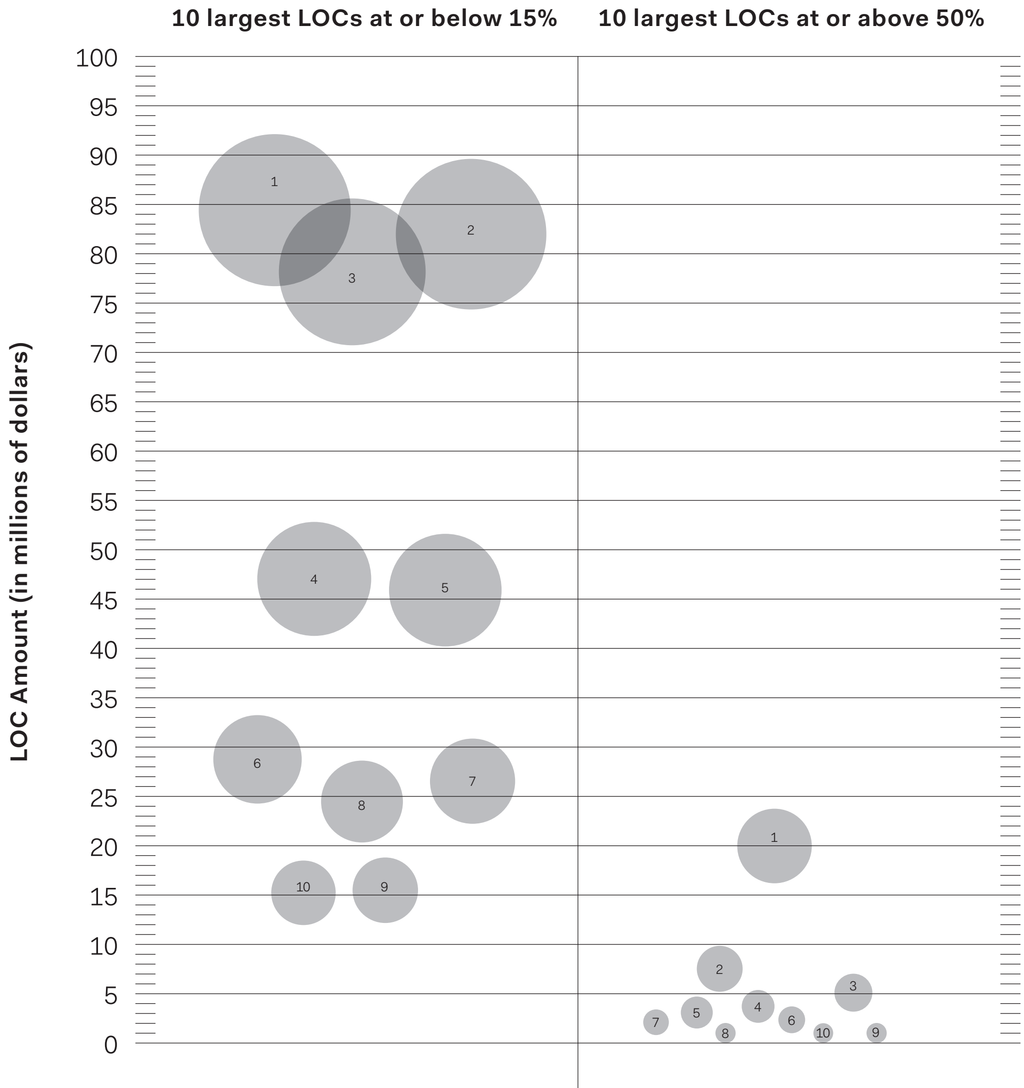
Appendix A



1. Argosy University	15%	
2. Walden University	10%	
3. ITT Technical Institute	10%	
4. South University	15%	
5. Art Institute of Phoenix (The)	15%	
6. Art Institute of Pittsburgh (The)	15%	
7. Virginia College	10%	
8. Keiser University	10%	
9. Miller - Motte Technical College	15%	
10. Art Institute of Atlanta (The)	15%	

1. Rensselaer Polytechnic Institute	50%
2. Carson-Newman University	50%
3. Tribeca Flashpoint College	50%
4. Santa Fe University of Art and Design	50%
5. Ex'pression College	50%
6. Baptist Health System School of Health Professions	50%
7. Erskine College	50%
8. SAE Institute of Technology-Atlanta	50%
9. Claremont School of Theology	50%
10. Dallas Nursing Institute	50%