PRIVATE EQUITY PERFORMANCE IMPROVEMENT

How Can the For-Profit Education Industry Respond to New U.S. Government Regulations?

Introduction / Summary

As an estimated 25 million students[1] pursued higher education at domestic institutions this past fall, the U.S. Department of Education formalized its most recent set of rules and regulations aimed at protecting students from what it considers to be low-performing educational programs. These rules have two major components: 1) Gainful Employment (GE) regulations that could ultimately prevent some programs from accessing federal student loans, and 2) Financial Value Transparency (FVT) reporting — and, in some cases, student acknowledgement — requirements.

The complexity of the regulations makes it difficult for many people to fully understand their scope and implications. In addition, there may be an information gap between the voluminous regulations themselves and short articles or blogs that tend to omit important specifics or raise more questions than they answer. Given that GE only regulates the for-profit portion of the overall U.S. education sector, there are inescapable ramifications that some of those organizations will need to deal with. The for-profit sector should quickly assess each institution's bespoke level of risk, blunt the effects and steer organizations into more stable and profitable futures, but how they handle the challenges will impact investment decisions within the sector in the future.

This article will attempt to strike a balance between these two extremes by:

1. Providing a brief overview of the background and context, particularly on GE regulations;
2. Summarizing the most recent round of efforts that have led to the new rules;
3. Presenting the outcomes of data-driven assessments of:
    a. Comments on the proposed regulations that were posted publicly;
    b. The scope of coverage for the final regulations; and,
    c. At-risk programs;
4. Analyzing implications for U.S. higher education generally; and,
5. Offering guidance to for-profit educational institutions and their owners / investors.

1. Background / Context

GE regulations began circa 2010 during the Obama administration. These rules targeted perceived profiteering within the U.S. for-profit education sector by attempting to force certain programs to bring their tuitions and other fees more in line with students' expected earnings after graduation. Programs that were unwilling or unable to accomplish this objective risked losing access to Title IV federal loan dollars for their students. Importantly, even though graduates of non-profit schools may be axiomatically susceptible to some of the same underlying issues, such as high debt and low earnings, as their counterparts at for-profit schools, GE regulations largely apply only to for-profit institutions.

1. This figure is an A&M estimate based on public data from the U.S. Department of Education, the Integrated Postsecondary Education Data System (IPEDS) and Statista. The Department of Education inputs include the Final regulations from the 10-10-23 Federal Register (2023-20385), the nprm-2022ppd-public-suppressed data set, etc.

Regardless of one's political leanings or beliefs about the underlying benefits of higher education, it is reasonable to say that GE is controversial. Proponents feel that it is an essential form of consumer protection by routing students away from programs that would make it difficult for them to quickly repay their student loans. GE has also enjoyed some support from within the traditional non-profit higher education space — both public and private — which collectively often takes a dim view of for-profit players and, in some cases, may resent the competition these players present.

Opponents of GE have raised a body of objections that includes both the practical, including that graduates' earnings are often under-reported because they do not include tips, and the ideological, asserting that looking solely at earnings misses other benefits that graduates receive — particularly those who pursue alternative educational and career paths. Some have also argued that GE misses the opportunity to create sweeping reform of the entire U.S. higher education landscape, opting instead to target the small minority of institutions and programs that are for-profit. Others find it to be ultimately anticompetitive, attempting to remove a thorn in the collective side of non-profit institutions that historically have not faced market pressures to change and evolve.

2. GE Round Two

After Democrats retook the White House in 2021, the Department of Education began researching and evaluating ways to reinstate and build upon the previous GE regulations. This two-year effort culminated in May 2023 with the publishing of draft rules, which were then open for public comment for a period of roughly one month, concluding in late June.

The Department of Education spent the summer of 2023 reviewing and synthesizing the nearly 7,600 comments that were made, which are outlined in the next section. A late September bulletin announced that the rules had been finalized and highlighted the features that the Biden administration considered to be most relevant.[2] The full set of rules, 190 pages long, was published in the Federal Register on October 10 and goes into effect on July 1, 2024.[3]

While the timelines are unambiguous, the same cannot be said for the likely effects of the rules. No consensus viewpoint has emerged, and there also appears to be some uncertainty about the relative scope of coverage. The Assessment sections below will attempt to address that.

3a. Assessment – Public Comments

Nearly 7,600 public comments were received by the Department of Education during the open period. Our AI analysis of a large sample of the posted comments[4] suggests that respondent categories were split as follows:

Category	Est. % of Comments
Impacted Business Owner	28% to 32%
Educator	26% to 30%
Former Student	18% to 20%
Current Student	5% to 8%
Customer / Client	1% to 2%
Miscellaneous / Unknown	14% to 16%

In reality, some commenters likely fall under multiple categories. However, from a content standpoint, many comments received from individuals expressed concern about the proposed rules — in particular, their potential effects on programs offering vocational training in fields such as cosmetology and massage therapy. A number of these responses argued that these types of programs not only benefit non-traditional students but also have positive overall economic effects in their communities.

2. Biden-Harris Administration Announces Landmark Final Rules to Protect Consumers from Unaffordable Student Debt and Increase Transparency (govdelivery.com)
3. 2023-20385.pdf (govinfo.gov)
4. Regulations.gov

Comments that were aggregated and / or from institutions, rather than individuals, tended to be much more positive about the regulations. For instance, a Boston-based group called The Project on Predatory Student Lending submitted a letter favoring the proposed rules that was signed by nearly 3,600 students who claimed to be victims of predatory lending in the past.[5] Our analysis of the institutions previously attended by these signers revealed, perhaps tellingly, that roughly half of them attended schools that are now no longer operating:

Institution Status	# of Students Signing	% of All Signers
Defunct	1,793	49.9%
For-Profit	1,369	38.1%
Non-Profit	260	7.3%
Unspecified	168	4.7%
Total	**3,590**	**100.0%**

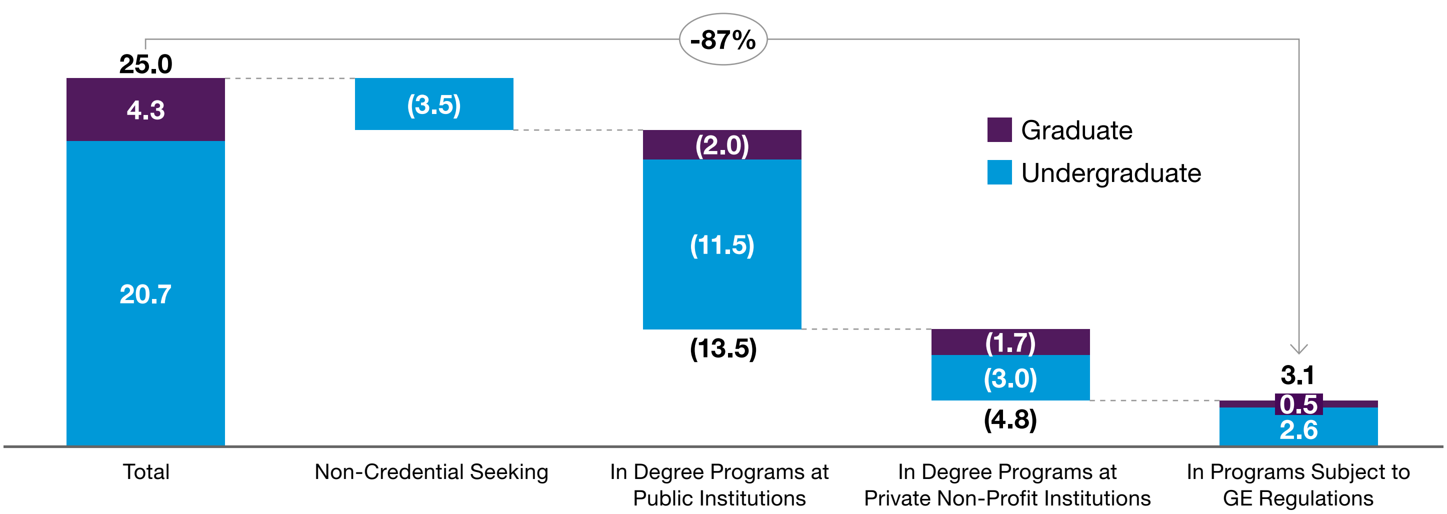
It may also be worth noting that, when signers with no institution listed and non-profit schools are both taken into account, the percentage of signers who attended schools that will actually be affected by the new regulations goes down to only about 38 percent.

One institution with even less skin in the proverbial game nonetheless offered a viewpoint that was neutral-to-negative on the proposed rules. The National Association of Independent Colleges and Universities (NAICU) represents non-profit higher education, which is largely not being targeted by the regulations. Nonetheless, NAICU raised a number of concerns in its letter,[6] concluding "A financial value metric is not — and can never be — a true measure of the value of a higher education. While we agree that protecting vulnerable students is critical, we question whether the proposed regulations would meet that goal."

3b. Assessment – Final Rules & Regulations (Scope of Coverage)

For better or for worse, both the GE and FVT portions of the regulations target relatively small percentages of U.S. higher education students. The GE rules primarily apply to for-profit programs, which represent a minority of all programs offered. Our analysis of current student enrollment suggests that only approximately 13 percent of higher education students are in programs subject to GE.

Est. 2023-24 Enrollments (Thousands) in FVT Acknowledgement Programs



Source: A&M analysis, based on (public) data from U.S. Department of Education and Integrated Postsecondary Education Data System (IPEDS).

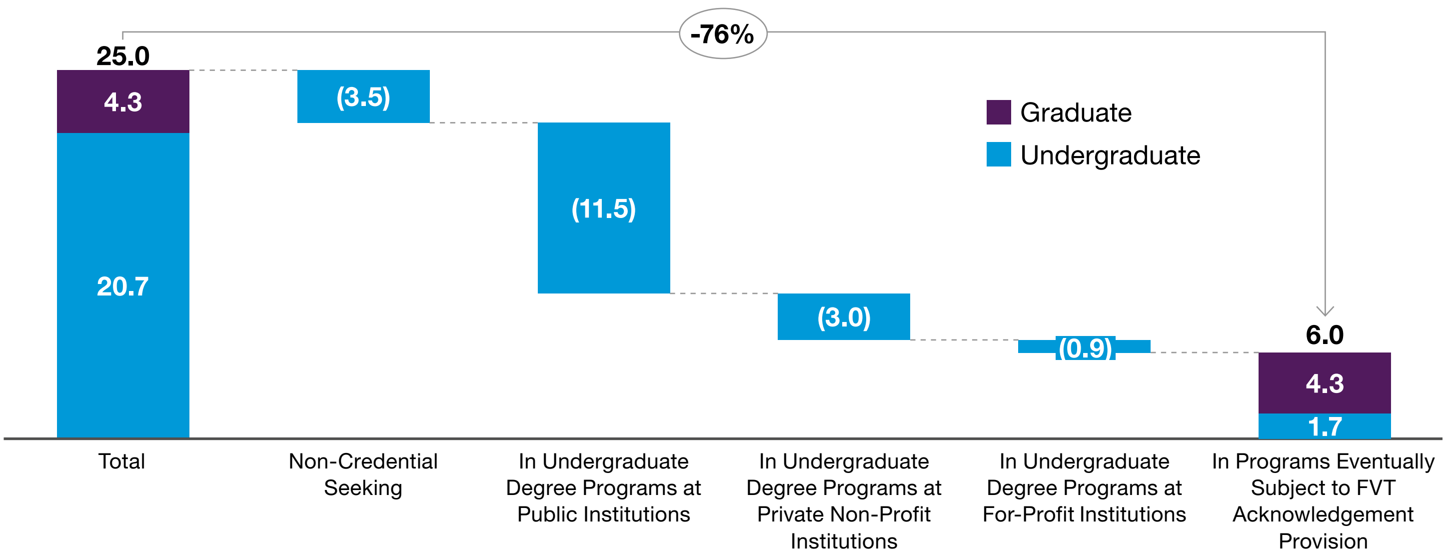
5. Regulations.gov
6. Regulations.gov

This 3.1M estimate includes all enrollments at for-profit institutions. We estimate the current for-profit enrollment total to be approximately 2.1M,[7] which is roughly two thirds of the approximately 3.1M enrollment in programs that are subject to GE regulations.

For the FVT portion of the regulations, calculating the percentage of students affected is more nuanced, because FVT contains two different components:

- The reporting requirement of the FVT, which goes into effect in mid-2024, applies to all programs. It includes data on typical earnings outcomes, borrowing amounts, attendance costs and sources of financial aid — which will all be made available to prospective students.[8]
- The potential acknowledgement requirement applies only to graduate and non-degree programs — since undergraduate candidates are often admitted to a college or university, rather than to a specific program at that institution. Our analysis concluded that approximately 24 percent of all higher education students[9] are in programs that will be subject to this part of the FVT.

Est. 2023-24 Enrollments (Millions) at Title IV-Eligible Institutions



Source: A&M analysis, based on (public) data from U.S. Department of Education and Integrated Postsecondary Education Data System (IPEDS).

We estimate that about 20 percent, approximately 1.2M, of the 6.0M total students are enrolled in programs at for-profit institutions.[10] Since the estimated total for-profit enrollment is approximately 2.1M, the 1.2M figure implies that around 55 percent to 60 percent of students in for-profit institutions are enrolled in programs that will eventually be subject to the FVT acknowledgement provision.

Note also that the FVT acknowledgement requirements will not go into effect until 2026.[11] Importantly, programs that are subject to acknowledgement requirements are not necessarily going to fail the tests that would necessitate actual student acknowledgement before enrollment.

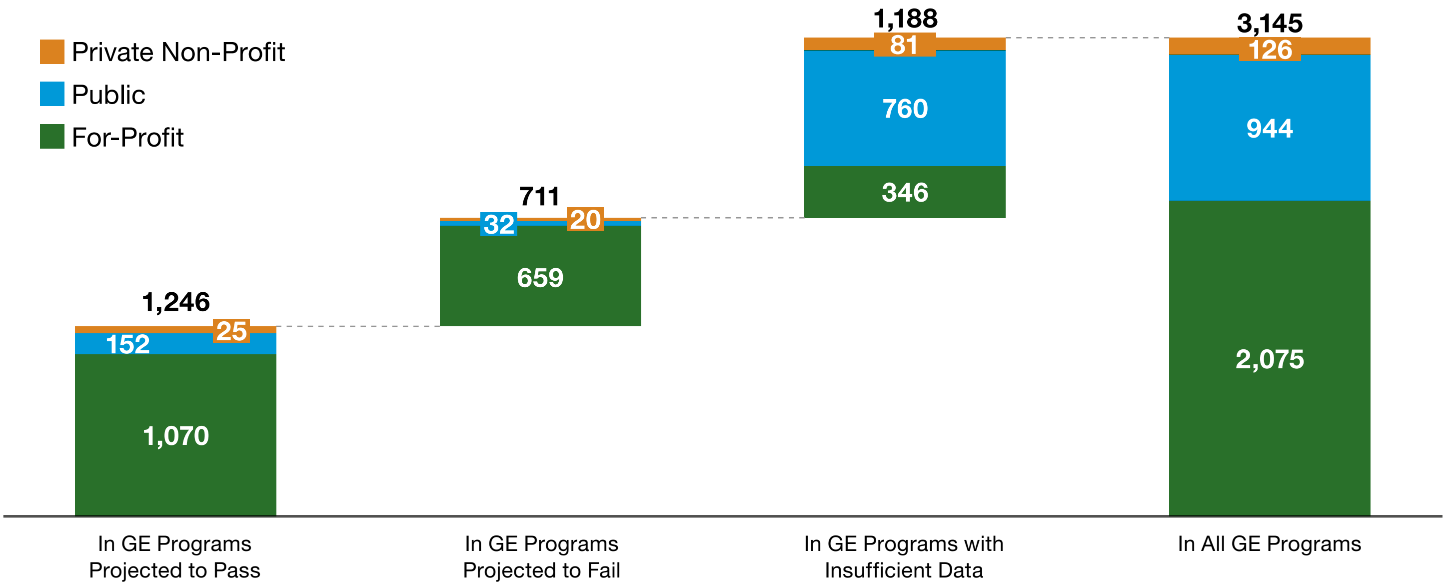
7. As is the case for the estimates in the chart, the source for this estimate is A&M analysis, based on (public) data from the U.S. Department of Education and the Integrated Postsecondary Education Data System (IPEDS).
8. gainful-employment-notice-of-final-review-factsheet.pdf (ed.gov)
9. The numerator of this percent, approximately 6.0M students, includes those enrolled in medical and dental professional programs, which will be evaluated under the new FVT acknowledgement regulations.
10. As is the case for the estimates in the chart, the source for this estimate is A&M analysis based on public data from the U.S. Department of Education and the Integrated Postsecondary Education Data System (IPEDS).
11. gainful-employment-notice-of-final-review-factsheet.pdf (ed.gov)

3c. Assessment – Final Rules & Regulations (At-Risk Programs)

The Department of Education also estimated the number of programs that it considers to be low-performing — at risk of failing one or both GE tests once the rules go into effect — at 1,700. We estimate that these programs currently collectively enroll around 711,000 students.[12] Using the GE denominator of 3.1M estimated in the previous section, the estimate suggests that 20 percent to 25 percent of students in programs targeted by GE are in programs considered to be low performing. However, the low-performing programs enroll only about 3 percent of all current U.S. higher education students.

For-profit institutions enroll an estimated 90 percent of the students in low-performing programs (659,000 of the 711,000 total). Given the total current enrollment of 2.1M at for-profit higher education institutions, we estimate that over 30 percent of these students are in low-performing programs.

Est. 2023-24 Enrollments (Thousands) in GE Programs



Source: A&M analysis, based on (public) data from U.S. Department of Education and Integrated Postsecondary Education Data System (IPEDS).

For the FVT, programs subject to the acknowledgement provision will be assessed under the debt-burden measures beginning in 2026. In programs failing this test, prospective students will be required to acknowledge viewing this information before entering into an enrollment agreement with the institution.

Our analysis of low-performing programs that are subject to the FVT acknowledgement provision shows that fewer than 400,000 students are currently enrolled in programs that are projected to fail, which would trigger the student acknowledgement requirement. This number is only about 6 percent to 7 percent of the estimated 6.0M total students enrolled in programs to which the new FVT test would apply. This percentage is much smaller than the corresponding GE percentage in part because GE has two separate tests that a program could fail while FVT has only one.[13]

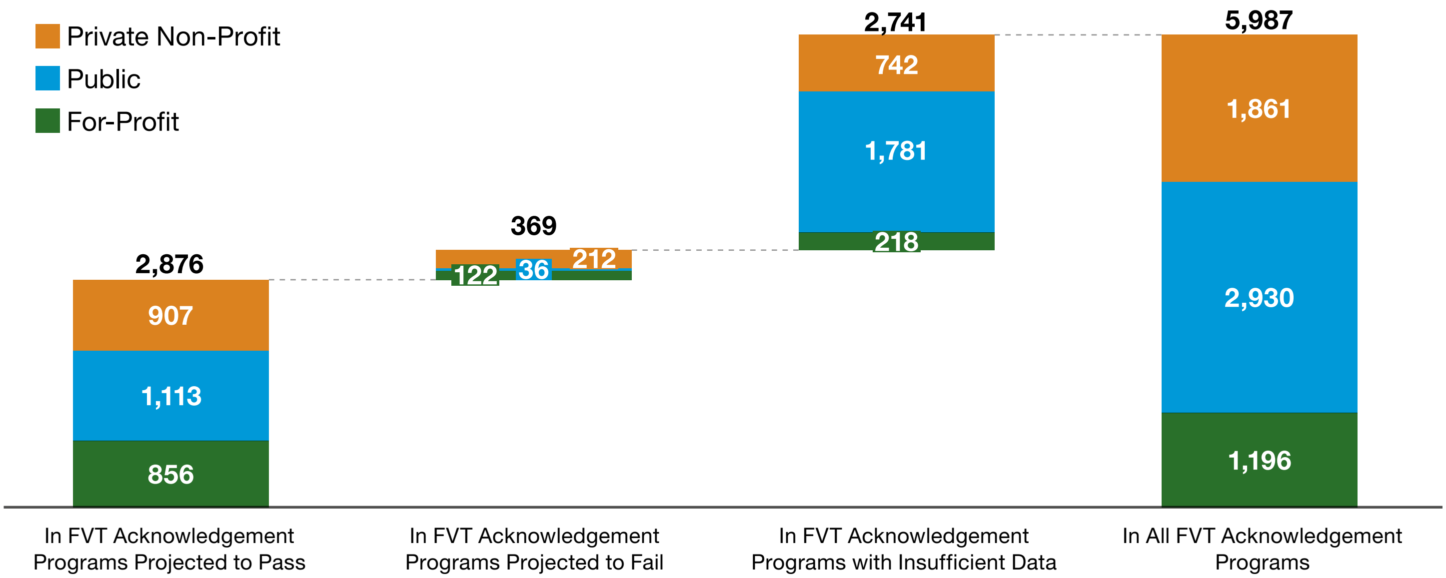
For-profit institutions are estimated to have a higher failure rate — around 10 percent of all students enrolled in for-profit programs that are subject to this provision. Furthermore, roughly one third of all students enrolled in FVT acknowledgement programs that are projected to fail — 122,000 out of 369,000 — are in for-profit programs.[14]

12. This A&M estimate is based on public data from the U.S. Department of Education and the Integrated Postsecondary Education Data System (IPEDS). It differs slightly from the Department of Education's estimate of 695K students, which is rounded to 700K in some Government publications. The difference is due to the Department using mid-2010s data, excluding newer GE programs and including only students who are actually borrowing through Title IV. Our estimates are of enrollments in the current academic year (2023-24), across all GE programs and across all enrollments in these programs — including students who are financing their education privately.

13. Specifically, GE will use tests on both Debt-to-Earnings ratio (D/E) and Earnings Premium (EP), while FVT will use only the former.

14. The estimated number of students in public / non-profit programs that are projected to fail is somewhat higher than the U.S. Department of Education's corresponding estimate. This is due to a confluence of reasons — e.g., enrollment growth over time, new program additions over time, etc.

Est. 2023-24 Enrollments (Thousands) in FVT Acknowledgement Programs



Source: A&M analysis, based on (public) data from U.S. Department of Education and Integrated Postsecondary Education Data System (IPEDS).

4. Implications

The implications of the GE rules present a peculiar dichotomy. Since they apply to only about 13 percent of all U.S. higher education students, the regulations will likely not have a major effect on the overall landscape for post-secondary education in this country. However, the implications for the U.S. for-profit education industry will likely be significant. The GE rules apply to 100 percent of higher education programs offered by the industry, with nearly a third of students at for-profit institutions enrolled in programs already identified by the Department of Education as low-performing and are therefore at risk.

Far and away the biggest specific risk to individual programs is the potential loss of Title IV eligibility, which gives students in those programs the ability to use federal student loan dollars to help finance their education. In many programs, a large majority of attendees are tapping into these federal funds, so the loss of Title IV could have a significant impact on a program's future enrollment levels. In some cases, the enrollment drop in the program could be so significant that the institution running it might be forced to wind it down altogether.

There are secondary and tertiary risks to for-profit programs as well. For instance, a program could endure reputational deterioration from an adverse finding, even though the first failure will not be enough to result in a loss of Title IV access. In fact, the reputational damage could begin even before the regulations go into effect in mid-2024 because the Department of Education has already identified numerous low-performing programs.

GE implications for traditional non-profit institutions of higher education are minimal. As above, the only non-profit programs that are subject to these regulations are non-degree (i.e., certificate) programs. Many colleges and universities do not offer these programs at all, and the institutions that do offer them usually derive only a small percentage of their revenues from them. Closing a low-performing certificate program could cause a nuisance for a university and / or subject it to some reputational risk at the margin but would likely not significantly threaten its infrastructure or overall viability.

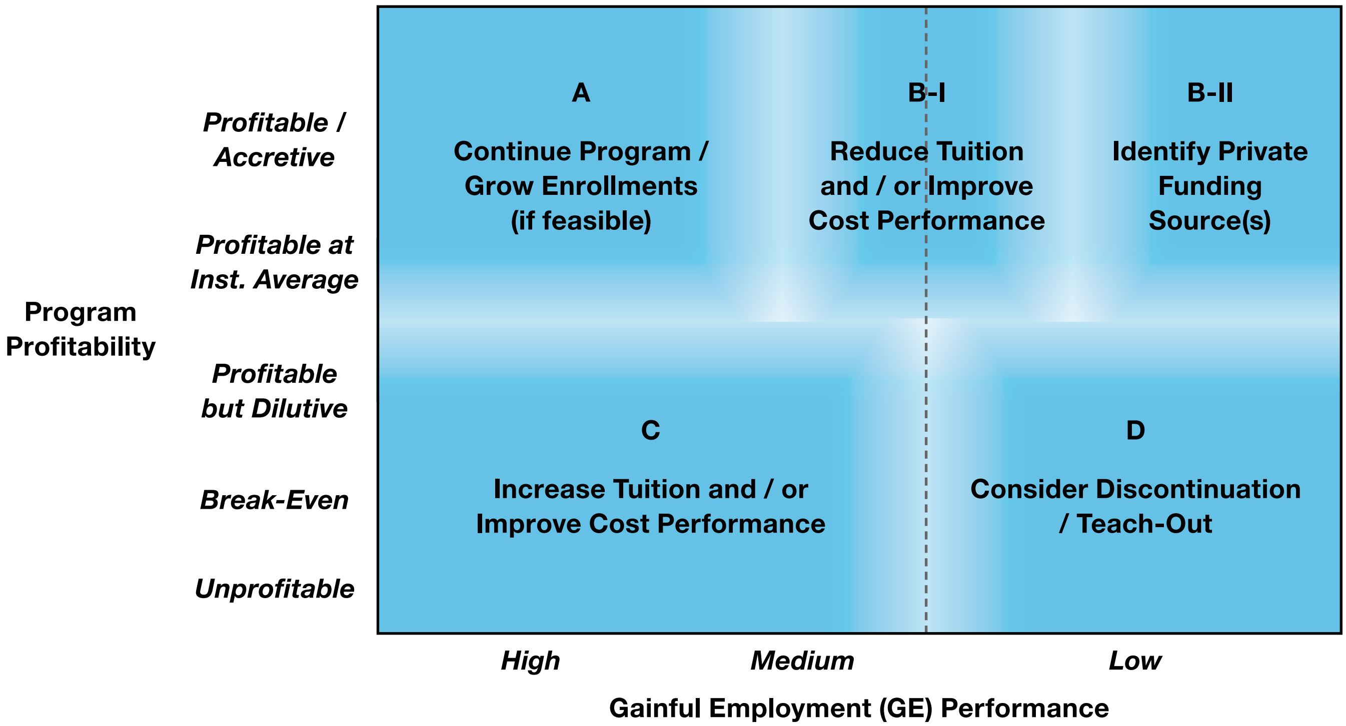
For the FVT portion of the rules, implications are much murkier and less direct. FVT is initially just a reporting requirement, and institutions will only incur the operational cost of fulfilling the requirement through data submission. That cost may be minimal if the institution is already gathering the data for its own purposes, but this will not always be the case.

When the FVT acknowledgement requirement kicks in during 2026, the risk to affected for-profit institutions will be difficult to quantify. The programs that are covered must pass a performance test, as with GE, but with consequences of failure that are less grave. That said, a forced acknowledgement could discourage potential students from enrolling in, or even applying to, low-performing programs if the students are concerned about high attendance fees, low post-program earnings or both. However, a for-profit program that fails the debt-to-earnings (D/E) test for FVT acknowledgement will fail the same test for GE as well, in which case GE proves to be the much greater of the two risks.

5. Guidance

This newest round of regulations poses a threat to the for-profit education industry, which is already only a tiny portion of the overall U.S. economy. That said, there are strategies and tactics that for-profit institutions and their investors can pursue to minimize the impact.

Before anything else, institutions must begin by assessing the likely impact of the new rules on each of the programs that they offer. While all programs within for-profit institutions will be subject to the GE rules, some will be more vulnerable than others. An even better practice is for institutions to not only understand GE performance based on the Department of Education's criteria, but also to use this opportunity to analyze the profitability of each of their programs. Overlaying the GE performance of each program with that program's contribution to overall institutional margin can help form a holistic approach:



A. Programs that are both profitable and well-performing from a GE standpoint should be continued and grown to the extent possible.

B. Programs that are profitable at or above their institution's average, but low performing on the GE tests, will require a careful approach.

   I. If a program is near the GE threshold, then a small tuition reduction may enable it to pass the GE test and still remain profitable. Pairing this reduction with an improvement in cost performance could enable the institution to preserve margins while still reducing tuition.

   II. However, if a program is significantly below the GE threshold, the institution should focus its efforts on identifying private funding source(s) that current and future students may be able to use to finance their education.

C. Conversely, a program that is only marginally profitable, or even unprofitable, but high-performing from a GE standpoint might be a good candidate for a tuition increase — if it can make the program profitable while keeping it above the GE performance threshold. For programs such as this, a market study can help assess whether or not a tuition increase is viable. Reducing costs through performance improvement will further help these programs to become more profitable while maintaining high GE performance.

D. A program that is both unprofitable and low-performing may be appropriate for a discontinuation / teach-out, which might ultimately be in the best interests of the institution, the students in the program and the Department of Education.

In instances in which a program is close to the GE performance threshold, the institution could also choose to make incremental investments in career placement of graduates. Regardless of whether this investment is in addition to a tuition change or instead of one, it may benefit all stakeholders if it can drive even a marginal increase in placement rates. Also, these increased placement efforts could be done in parallel with cost reductions in less impactful functions.

There are several other high-level strategies that could be deployed at the institutional level — rather than at the level of individual programs — if necessary. One possibility is for the institution itself to attempt a conversion to non-profit status to the extent that this approach is viable from an investment standpoint. Importantly, this change will require approval from the Department of Education, so it should be pursued only after careful consideration of all available options.

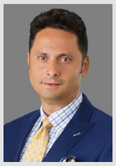
One final comment — investors who are interested in the sector generally, but not currently investing in it, will obviously want to proceed with caution when considering for-profit educational institutions. At a minimum, investors will need to understand how the GE — and, if applicable, FVT — rules will affect each of the institution's programs, as well as the institution itself. If opportunities seem limited, then exposure to the education sector could also come in the form of other investments such as educational technology (EdTech), K-12 education and more.

Conclusions

It is difficult to say that these new regulations will be a net positive for for-profit educational institutions, either individually or collectively. However, schools in the sector should not waste the opportunity that any crisis presents. An understanding of both the depth and breadth of its own specific risks will benefit each institution, especially if it has the acumen and discipline to overlay this assessment with a program profitability analysis and / or to undertake cost improvement efforts in programs with marginal financial or GE performance.

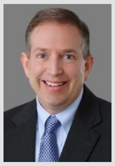
With the rules now finalized, there is no longer merit in debating whether or not their effects will match their intentions. Each for-profit institution must instead focus on identifying and following its own best path forward from here.

Key Contacts:



Vadim M. Tsysin
Managing Director
Chicago, IL

+1 847 287 8690
vtsysin@alvarezandmarsal.com



Edwin Van Dusen
Director
Chicago, IL

+1 312 471 5234
evandusen@alvarezandmarsal.com

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