Morgan Stanley's Call on Regulatory and Legislative Issues in the For-Profit Education Sector
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Corporate Speakers

- Suzi Stein Morgan Stanley Analyst
- MaryEllen McGuire White House Domestic Policy Council Former Senior Education Advisor
- Chuck Gabriel Capital Alpha Political Risk Consultant

Participants

- Jordan Hymowitz Philadelphia Financial Analyst
- Shawn Crawley
- Steve McKay
- John Selenez

PRESENTATION

Operator: Good morning. My name is Thea and I will be the conference operator today. At this time, I would like to welcome everyone to Morgan Stanley's Call on Regulatory and Legislative Issues in the For-Profit Education Sector. All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question and answer session.

(Operator Instructions)

Thank you. I will now turn the call over to Ms. Suzi Stein of Morgan Stanley. Please, go ahead, ma'am.

Suzi Stein: Good morning, everyone, and thanks for joining me today to talk about the regulatory and legislative issues facing the for-profit education sector, which I know is top-of-mind for everyone on this call, long, short or sideline.

Before we begin, I need to read the appropriate disclosures. Please refer to the Morgan Stanley website for important disclosures at www.morganstanley.com/researchdisclosures.

On the call with me today is MaryEllen McGuire, who I had the pleasure of meeting with recently and I found her insights to be very useful in trying to get a handle on how policymakers are thinking through some of the issues, whether it's gainful employment or potentially new legislation.

MaryEllen was, until last month, a Senior Advisor for Education on the White House Domestic Policy Council, where she played a leading role in developing some of the program integrity issues, particularly gainful employment. Prior to that, she was a senior Democratic staffer on the Senate Health Committee and she also spent time at the New America Foundation. She has significant policy making experience and, I think, has a very interesting perspective on what's going on in for-profit education.

Also on the call is Chuck Gabriel, a Political Risk Consultant from Capital Alpha, who is co-hosting the call with me and he will provide some insight on what's going on in Washington as well.

I would like to remind everybody that Chuck and MaryEllen are not members of Morgan Stanley's research department. Unless otherwise indicated, their views are theirs and may differ from the views of the Morgan Stanley research department and from the views of others within Morgan Stanley. We make no representation that any of our guest speakers' presentations are accurate or complete.

I'm going to start today by asking MaryEllen a few questions on the regulatory environment, and then Chuck will ask some on the political environment and then we'll open it up to participants for Q&A.

Suzi Stein: So just to kick it off, MaryEllen, and first I'd like to thank you for doing the call with us this morning. I'm particularly interested in the background on how the gainful employment rules were developed. It seemed, from the get-go, that they were a little bit arbitrary on the 35% to 45% thresholds and the 8% to 12% thresholds and I'm just curious if you can just talk through the logic that was used by the department and just briefly talk about the process and how they ultimately got to those levels?

QUESTION AND ANSWER SESSION

MaryEllen McGuire: Sure. Thank you for having me today.

Well, on the 8% and the 12% specifically, the 8% was something that they derived, really looking at taking in some expert opinions into account, Sandy Baum is a professor that we've taken a lot of -- we're really taken her perspective, she's done a lot of studies around this. And 8% seems to be something that students can actually bear once they graduate.

We also looked at underwriting criteria and found that in a lot of -- in terms of commercial loans, especially -- even loans at the state level, what folks are looking at is 8% again seems to be a percentage that students can bear in relation to all the other debts that they may have, whether it's mortgages that they have to pay and car loans. So 8% was a standard that we could really sink our teeth into.

The 12%, quite honestly, is just 50% more than the 8%. That was just a number that the department felt made some bit of sense. On the 35% and the 45%, the way that education legislation generally works whether it's K-12 or higher ed is, quite honestly -- we do something called runs where we run a whole different -- we run percentages, 20%, 25%, 30%, 35%. We look at where they land.

We see, sort of, what the percentages may be in terms of who falls into the category and we think about what we believe the market can bear. And really what I mean -- market, when I talk about it, is from a student perspective. There is certainly some worry if that -- if we go above a certain threshold -- and we have, maybe, 20% of these institutions that are identified.

Where will these students then go if the no longer can attend these particular institutions? We certainly need some time -- a little bit more time, to build our community college system. So the 35% and 45% is really just the result of running numbers and deciding that those made a bit of sense.

Suzi Stein: I guess given that and given that proxy data was used on the income levels, do you -- what do you think happens if they find out that instead of impacting, I guess they said it was 5% of programs, it actually impacts 15% or only 2%? I mean, do you get the sense that the department would make a significant change in the thresholds to ultimately get to, I guess, whatever the maximum payment they think the market can bear is?

MaryEllen McGuire: Yes. I certainly -- my opinion is that I think that the administration is probably, if anything, willing to go a little harder on the threshold. The problem was, again, we were using proxy data. We didn't have access to the actual income data yet. There were a lot of -- they're really sort of hedging their bets here.

But I do believe, part of the reason that they're releasing all this information on Friday, and a part of the reason that they released an appendix to this particular rule, is because they want others to do additional analysis for them. I think if they can justify a higher percentage, they certainly will.

I don't -- I cannot imagine any circumstance where the administration would pull back on those numbers. If anything, they're getting hit a little bit harder on the consumer side. A lot of the student groups and consumer groups feel that 35% in particular is very, very low. Given the GAO report that recently came out, given the hearings that are going on, there is momentum to, I think, really, if anything, strengthen this a bit. But the administration will only do that if they have the data that justifies that.

Now if we run the data -- if they run the data or someone does more analysis and it turns out then that even at 35%, they're identifying 15%, for instance, of the institutions, it may cause them to take another look. But again, 35% is fairly low and even from a -- from sort of a political and a sort of a messaging perspective, I don't -- it seems unconscionable to go below that.

Suzi Stein: Okay. Can you also just address how involved the White House was on gainful employment? I mean, did they get, and are they still getting, push-backs from minority groups just on the issue of restricting access? Particularly when it's pretty widely known that community colleges can't necessarily handle the overflow?

MaryEllen McGuire: Yes.

So the White House was very involved. There were several components at the White House that were involved and were from the very start. The White House was briefed immediately after the negotiated rule making sessions. So we knew where -- what had happened and what hadn't happened; the fact that agreement certainly hadn't been reached with some of the issues that were brought up.

They were involved throughout the process, over those subsequent seven months in developing the rule. Components that were involved were the DPC, Domestic Policy Council, which I sat on, The Council of Economic Advisors, the National Economic Council, the OMB and OIRA, which is the regulatory arm of the office management -- Office of Management and Budget.

The White House was extremely involved in this from start to finish. And, of course, any rule that goes through and is (inaudible) it ultimately has to be approved by the White House. But in this particular instance, given sort of what was at stake in terms of financial aid, this wasn't just a matter of we were given the final rule a few weeks ahead to approve, we were involved throughout the entire development.

Suzi, what was the other part of your question? I apologize.

Suzi Stein: I mean, the other part of the question was just in terms of how that's balanced with the issue of community colleges being -- overflowing right now because of budget cuts, and I guess how they weighed the importance of this with the problem that they have in the community college system now?

MaryEllen McGuire: So I think (inaudible) be a transition year, if you allow, again, some extra time for us to build the capacity there. There is a community college grant program that's going to be released, if not in September, in October, most likely, I would guess, at the -- the Second Lady, Dr, Biden is having a community college summit at the White House in October. This is likely to be a deliverable for that conference.

It's millions of dollars that will pour into the community college systems to sort of bolster the way that they teach and really, honestly, bring some models into the community college system to increase their capacity.

It may actually involve taking some of the more successful components of the for-profit sector and introducing them into the public sector. So they -- the for-profit sector does a particularly good job at meeting students wherever they are. There's a lot of online course work, there are classes on the weekends and evenings; some of them actually have classes at midnight that are over-subscribed because they really meet the students where they are.

So, there is this move to invest more dollars at the federal level. I think you'll likely see a few other announcements at the Second Lady's conference in October, which I cannot discuss because they're not yet public. But, I would keep my eye on that particular grant program.

One thing to note -- just on a side note for one moment, is when the Student Aid and Fiscal Responsibility Act was passed in March, the Senate parliamentarian would not allow any new programs. The Community College Fund was a key piece of the President's agenda. The only way they were able to fund it was to track the money through an existing program that had never been funded. That particular program actually allows for-profits to compete.

The White House -- and this was very public, was working with Senator Harkin and others to introduce a change that would remove them from actually being able to apply from those dollars; that has not yet happened. So it may be that when that grant program is announced, for-profits are actually able to apply for those dollars as well.

Suzi Stein: Okay. Great. On a separate issue, one of the things that the department clearly commented on the call yesterday was the conflict between 90/10 and the inability of schools to restrict borrowing. So now that they have what looks like a viable [JE] proposal from their perspective, how do you think they're thinking about 90/10? Is there any urgency from the department standpoint to address either 90/10 or the inability of schools to restrict borrowing?

MaryEllen McGuire: Well, it's -- certainly there's an understanding that if this rule certainly makes it to the process and once it is announced, they may need to go back and look at 90/10, but I don't think they're willing to sort of think ahead quite yet. They're sort of taking it one day at a time. So, I haven't heard discussion around specifically how they would view that.

Suzi Stein: Okay. Then, I'll just ask one more question. At last week's Senate hearings, we heard repeatedly that the rules are in place, there's just nobody enforcing them. They seemed, in part at least, to be blaming the Department of Education for being lax on enforcement. Do you think that in the wake of hearings, we should expect the department to step up some of the enforcement actions?

MaryEllen McGuire: So, I think it's interesting because actually the reason that the department moved forward on this was because we have the power to enforce it, but it is not enforceable because we cannot design -- because gainful employment is not designed. So there's no way to actually enforce a rule when you have no idea what it means and that's why the department has to take the extra step, it's so that they can enforce it.

Suzi Stein: But even going back to some of the things that they showed with respect to deceptive marketing practices, it seems that those -- they haven't been that aggressive in recent years in enforcing some of these things. I mean, do you think that the hearings and just the attention that's being paid to the department now is going to drastically step-up the efforts to enforce some of these rules?

MaryEllen McGuire: Yes. I mean, I certainly think you'll see a difference. I think you'll see the biggest though, after all the rules are published on November 1st.

The -- part of the problem right now, when you're thinking, even on the recruitment side, over the -- the former administration did quite a bit to loosen those rules and put in place safe harbors, where that really allows folks to keep recruiting be keep getting dollars for the number of students that they've recruited, whether or not they were actually qualified.

Once these new rules in place, it will be very clear where the lines are drawn. I think it'll make it easier and clearer, and I would imagine that the department would step-up their enforcement --.

Suzi Stein: Okay. Why don't I go ahead and turn it over to Chuck to talk more about the political environment?

Chuck Gabriel: Thanks, Suzi. Good morning, MaryEllen. A couple of questions. I mean, the for-profit industry and its defenders have historically tried to deflect criticism by suggesting that the abuses have been committed by only a few bad actors. But the August 4th Senate Health Hearing on the GAO's undercover investigation of the prof schools pointed to seemingly systemic misrepresentation and perhaps prevalent fraud.

It clearly put the industry on the defensive, Kaplan suspended enrollments at a couple of schools that had been focused on by the GAO, and the CCA came up with a new code of conduct and secret shopper enforcement plan of its own. Then Terry Hartle, who represents traditional four-year schools as we all know well, at the American Council of Education, said by the end of last week that the world had changed last week.

So my question is really a very broad one, but has the conversation changed as Inside Higher Ed framed the question on Monday? If so, in what way do you think?

MaryEllen McGuire: No, actually, I do see a change. I think it certainly is bolstering the argument, in terms of it's empowering folks like Senator Harkin that certainly weighs on the side of the administration in terms of the need to move forward on this.

One of the things that Suzi mentioned earlier, and I realize I didn't answer it after the fact, was just prior to that hearing, some of the civil rights groups, more of the -- not the big civil rights groups, some of the ones that probably most of you haven't heard of, sort of the more specialty and niche ones.

We're working with, for instance, folks with the Congressional Black Caucus. And some of our legislators in urban areas, really came out in support of the for-profits and said that we were limiting access to their constituencies by going after them, and that that was wrong.

After the GAO study and the fact that all 15 of those institutions were doing something, to some extent, that we're wrong, a lot -- I think it's really shamed people away from defending them. So, we've actually seen people pull back from defending them certainly within the Democratic caucus.

Chuck Gabriel: Thanks. What you've [told us] the conversation has changed -- just to drill down a little bit more on how it's likely changed or the impact of it, do you think beyond likely hardening the gainful employment program, integrity regs as you discuss with Suzi a minute ago, do you think legislation's now inevitable? And if so, at what time schedule, to what effect might it address?

MaryEllen McGuire: I think it's just -- I think a lot of it will depend, honestly, on the elections. It's much too late in the year for Democrats to get a bill together and pass it before they leave. There's only a few weeks left in the session when the come back and they have quite a bit to do. I would be very surprised if anything moves.

They may introduce a bill. Some of those things -- Senator [Franken] has actually been way out on there on this actually gave a speech a few weeks ago, where he outlined what a bill might look like. And Senator Harkin's staff, I know, has been talking to him quite a bit.

So I think they're -- while there's interest on the Democratic side, if they do not maintain large enough numbers, it's not just a matter of the fact, even if they hold the Senate, if the numbers -- if they're down to 52/48 there are enough Democrats that do not want to dabble in this area when they may just not have the momentum that they need to move forward.

I -- my guess is some of the places where you may see some movement regardless is the bankruptcy piece, making student loans dischargeable at bankruptcy, at least on the private student loan side. I think that's something, regardless, as long as they hold onto the Senate to some extent, that could be something that folks could look at.

In terms of regulating private loans more generally, which there is a lot of interest in, especially in the Senate, I think the Democrats would have to maintain a pretty strong number to do that.

Moving forward on getting harder on accreditation may be something that folks want to do legislatively, especially in regard to schools that are basically buying accreditation by buying other schools. That's a pretty big concern to folks.

Another place where I think people are particularly interested in is this idea that many of these for-profits are spending much more on their advertising than they are on their instructional costs. I could very easily see a movement where folks want to limit the amount of federal dollars, especially those that are close to the 90 on the 90/10 that can be used for marketing purposes, certainly over direction.

But, again, whether or not that has legs at the end of the day really depends on where the Congress goes.

Chuck Gabriel: Thanks. That's really helpful. I just want to close it off with one sort of multi-faceted question. It really does relate to whether the prospect of a realignment after November really, really -- what kind of impact it might have.

I looked at the hearing on the fourth and I thought really one of the more interesting takeaways was that it's -- I think everybody was, obviously, kind of shocked and numbed a bit by the GAO findings. But I thought one of the other more interesting takeaways was that Republicans, a, they posted. You actually had a broader participation by Republican members of the Senate Health Committee and they seem to be somewhat unified and certainly more than they had beforehand.

They have a -- they've unified around a pitch saying that we have existing laws, as you all were discussing earlier, that just aren't being enforced, so we need to enforce existing loans, we need to penalize bad actors, but then moving forward, that they want to broaden the discussion to impact not-for-profits as well.

I think that there is a bit of a -- if not a conventional wisdom, certainly a theory, that to the extent that Republicans gain in November, perhaps or even taking the House, to the extent that they might try to broaden the conversation.

Again, the conversation has changed; if it changes yet again, and it changes in a way that would broaden the discussion, that would put at risk the interests of the traditional four-year schools, community colleges and others that have a lot more political clout, then just the for-profits.

You know, whether that would somewhat arrest the pace of reform and bring the decibel level down a little bit and, in that regard, whether the elections really do have any real implications to this story.

MaryEllen McGuire: Yes, again, on -- in terms of this argument that the rules are already on the book, again, I think that's nonsense. I was one of the negotiators that was in the room in '98 and in the room again in 2008. We all went out of our way not to define gainful employment, because we knew that we were not, as legislative staff, in the best position to do so. There was the recognition that that would have to be done for this to be reinforced. So I think it's a great messaging point; I don't think it's based in reality.

In terms of broadening that, of course, it's up to Congress. They can decide to extend this to other types of degrees and other types of institutions. The four-years are incredibly well organized and do a pretty good job of fighting things back. They are single-handedly responsible for really limiting proposals that the President put forward in -- around access and completion in the House last year.

The President wanted to limit his access and completion funds to states to four years. He did an amazing job at beating that back to make sure that they had a piece of the pie. I would imagine that if they are suddenly thinking that they will be subject to gainful employment that there will be a concerted effort, it will slow things down considerably and it could actually keep things from moving forward beyond what's currently in statutes.

Chuck Gabriel: Yes, that would seem to be a fairly effective strategy on the part of those trying to defend the industry, to do so, somewhat stealthily by trying to broaden the discussion. I mean, even accreditation, MaryEllen, is in some respects, could be a debate that -- a discussion that could somewhat threaten the not-for-profits. Correct?

MaryEllen McGuire: Yes. Accreditation is something that Secretary Spelling's tried to go after and, of course, was beaten back pretty quickly. Because, again, the four-years, whether they're public or non-profit are incredibly well organized.

If your state university president and calls up can pretty easily get a Senator or a Congressman on the phone to get the governor involved. It becomes a little bit harder to move forward on legislation then.

Chuck Gabriel: Okay. Then, I guess, the only question I'd ask is, again, the world does seem to change, certainly a little bit in the last week. Are there any other factors that could rock our world a little bit more, either later this year or early next like another GAO report or --?

In the call yesterday afternoon, the department acknowledged that it -- there were some inadequacies of the Missouri data and that they -- but nevertheless, particularly on -- in calculating repayment rates, that they are going to try to be entering into a data sharing agreement with the Social Security Administration.

So in terms of timing, another GAO report or additional data, does anything -- do either of those or anything else look like they might emerge, in your view, this fall or before the end of the year?

MaryEllen?

Suzi Stein: Operator?

Operator: Yes, she's still connected.

MaryEllen McGuire: I'm still connected. Hello?

Suzi Stein: I can hear you.

MaryEllen McGuire: Hello?

Suzi Stein: Hello?

Chuck Gabriel: Yes? MaryEllen?

MaryEllen McGuire: Yes, I'm here.

Chuck Gabriel: Oh, I'm sorry. Did you hear my question?

MaryEllen McGuire: I did hear -- I could hear you. You couldn't hear me.

Chuck Gabriel: Oh. Okay. I'm sorry.

MaryEllen McGuire: So in terms of GAO reports, those are confidential; they're just between the particular senator, congressman and GAO. So unless they put out a press release, there is no way of knowing if something's coming down the pike on that.

In terms of the data, yes, that's the sticking point, whether it's Social Security Administration or IRS. Although conversations so far, with the Social Security Administration have been quite successful, I think that the department is fairly confident that that will not be an issue, of course, they'd prefer to have IRS data and we're still waiting on that.

Chuck Gabriel: But with regard to the GAO, obviously the analysis that they've put forth in that report on the fourth, only partially responds to the letter that was sent by the -- .

MaryEllen McGuire: Yes.

Chuck Gabriel: All the members on the -- it seems like at the -- June 21st.

MaryEllen McGuire: Yes.

Chuck Gabriel: So there seems like there is more coming from GAO. Do you agree with that?

MaryEllen McGuire: On that particular issue, I do think you'll see some more. Whether or not there's other issues that are coming down the pike, it's to be seen.

Chuck Gabriel: Okay. I guess I do have one more question. It's interesting that we've -- the Republicans somewhat bristled by the Senator Harkin's, Senator Harkin activity on the hearing on the fourth. He's obviously enjoying what, for him, has really blossomed into quite an inquisition.

I -- there was some bristling, for instance, on his staying -- extending the hearing after all the Republican members had left and asking some really hardball questions that surprised folks on accreditation, for instance. So we've heard some characterizations on the Republican side that Senator Harkin and Senator Franken, frankly, want to do harm to the industry and that, frankly, their fairly hard-line views aren't necessarily shared as broadly within the rest of the Democratic caucus.

So not to put you on the hook or anything, but are -- is Senator Harkin poised to try to write some checks that the rest of the Democratic Party might not want to cash?

MaryEllen McGuire: Yes, I think actually, they share some pretty broad support. They have support in leadership to move forward on this. I think that this is a very hard issue for Democrats to be on the school side of it, especially in light of the GAO report.

The funny thing about folks sort of bustling over did Senator Harkin cross the line by continuing to go after folks, when the Republicans were in charge, I was in countless hearings where after Democrats had left, because they had other meetings that they had to go to, Republican senators then attacked Democratic witnesses.

So, that is not out of the ordinary. I think people were surprised that it came from Senator Harkin. I don't know that they had -- they haven't seen him in his new chairmanship, and they weren't sure that he would -- I don't know if they knew that he had it in him. But, it's certainly not out of the ordinary.

Senator Alexander is known for that. Certainly, when I was Staff Director of the Subcommittee on Children and Families, the Republicans were in control. I could tell you countless times that Senator Harkin -- that Senator Alexander, when Senator Dodd went on to his other committee chairmanship, would attack our witnesses. So, that's not out of the ordinary.

Chuck Gabriel: Okay. Crocodile tears. I hear you. All right. Thank you very much.

Suzi, back to you.

Suzi Stein: Okay. Why don't we turn it over to participants for Q&A?

Operator: (Operator Instructions)

The first question will come from Jordan Hymowitz.

Jordan Hymowitz: Hey, guys. Can you hear me okay?

Chuck Gabriel: Yes. Hey, Jordan.

Suzi Stein: Yes.

Chuck Gabriel: Yes.

Jordan Hymowitz: Hello?

Chuck Gabriel: Yes. Yes.

Jordan Hymowitz: Can you hear me okay?

Chuck Gabriel: We can.

MaryEllen McGuire: Yes. We can hear you.

Jordan Hymowitz: Sure. But thanks for taking my call. I have a question. There's a number of -- hello? Hello?

Suzi Stein: We can hear you.

Chuck Gabriel: We can hear you, Jordan.

Jordan Hymowitz: Sorry. There's a number of companies that have been formed such as Higher One, that seemed to be basically marketing and taking advantage of companies, of getting Title IV funds, whether it be through debit cards or other basically fee-based service business models. Do you think that this will be the next target of Senator Harkin's investigation or the Department of Ed as -- in terms of this is the students' money and instead of giving it to them in checks, they're basically using fee-based models to take some of the money that belongs to them?

MaryEllen McGuire: I'm not familiar with that model.

Jordan Hymowitz: Basically, instead of giving the students their Title IV money or what's left over for it, they put it on a secured debit card and then there's a penalty pricing fee-based model for students accessing their money.

MaryEllen McGuire: I have to say I haven't heard any discussion of that within the administration, so whether or not it's the next thing that they turn to, I couldn't speak to that.

Chuck Gabriel: Yes. MaryEllen, what's interesting about that is that it really seems to parallel, in some ways, all the righteous indignation that's welling up recently in the insurance space

MaryEllen McGuire: Yes.

Chuck Gabriel: Where a couple of large insurers in particular have been criticized for retaining death benefits or establishing checking accounts, essentially, rather than sending a single lump sum check to beneficiaries and then still investing the funds and benefiting in that regard. You've got sort of a broadening sense of indignation about that, is this legislation that is emerging, even the FDIC is looking at that.

So it sounds like what Jordan's describing, somewhat, sort of mirrors those kinds of practices. So, Jordan, you may be a little ahead of us on this one.

Jordan Hymowitz: Do you think that -- I know that Elizabeth Warren and Michael Barr has yet to be named to be the head of the distributor finance (inaudible), it's you or somebody else. But will -- do you think that companies targeting students through a high fee paying model will be a target of or a focus of that new administration for the department?

MaryEllen McGuire: I think it's interesting. There's certainly -- under that construct, there's a lot of interest in using it to think about what the for-profits are doing generally and private student lenders are, generally. So I would imagine that if this issue sort of rises to the top and people to begin -- hear more about it, it certainly is a great issue to come under that umbrella.

Jordan Hymowitz: Okay. Thank you.

Operator: We do have a question from [Shawn Crawley].

Shawn Crawley: Thanks for taking my question. It's actually a follow-up to Suzi's question about 90/10. I guess I specifically wanted to zero in on Pell Grants, Mary, and get your thoughts on how the department could be thinking about Pell Grants specifically as a percentage of the industry's revenue.

I guess what I'm trying to get my head around is if gainful employment is going to place, potentially downward pressure on certain programs, tuition prices, and we have an Obama budget that's contemplating linking Pell Grants and increasing them at the rate of inflation, I'm just trying to think about an increasing percentage of the overall industry revenues kind of coming directly from Pell.

MaryEllen McGuire: Yes.

Shawn Crawley: And depending on your inflation views, we could be baking in again sort of the industry needing to constantly raise tuition --

MaryEllen McGuire: Yes.

Shawn Crawley: -- to combat. So is that on anyone's radar, or -- ?

MaryEllen McGuire: Well, the Pell Grant issue is actually one of the reasons that the administration is especially interested in this issue. It's, certainly, first of all, protecting consumers. But it's also the fact that we just, in this past March, invested an additional $40 million in Pell Grants and a disproportionate amount of Pell Grant money is going to these institutions.

So, these are [tax] dollars that are not being used well. That's compounded, of course, by the amount of subsidized student loans that are being taken out and the fact that the government and the taxpayers are paying for that subsidization during school. So, it certainly is something that they're talking about.

In the appendix of the NPRM, there's an interesting statistic from the department that I haven't been able to get them to elaborate much on, but they actually see -- they have forecasted that about 50% of the industry is likely to lower their tuition to come into line with gainful employment, and they expect them to reduce their tuition by about 10%.

I've been told that that 10% is based on profit margins that are -- that they see in other for-profit sectors and that would bring it into line with other for-profit markets, but I have heard no elaboration of what those markets are.

Shawn Crawley: Yes, I certainly appreciate that. I guess, I'm kind of thinking about how that reduction in tuition will imply that the industry's reliance on Pell specifically as a percentage of revenue will actually go up. It just seems to me to potentially conflict with some of the comments out of Harkin, as he also chairs, I believe, the Appropriations Committee so --.

MaryEllen McGuire: And they have also said in the appendix that they expect that this could save the federal -- gainful employment could save the federal government, more than $400 million a year and a lot of that, of course, is Pell Grant money.

Shawn Crawley: Sure. Okay.

Chuck Gabriel: MaryEllen, is -- it's interesting, we had a interesting conversation with Mark Kantrowitz the last week as well. He made an -- a seemingly very rational prediction, which is that Pell Grants are not going to likely see the increases that the administration and the Congress would like, as we head into this really, really difficult funding period ahead.

So we may be into sort of flat funding on the Pell Grant side of it, and meanwhile the other side of the story -- maybe the real story line next year might be double-digit tuition increases at public schools across the country.

So, there is a disconnect between the market view that companies would need to raise prices to deal with much of this pain, and yet have to reduce prices in order to comply. There's such a disconnect between 90/10 and the gainful employment rules.

Yet, when you look at the notion of flat Pell Grant funding and then you look at the fact that you're going to have just an even further problem with regard to community colleges and enrollments, et cetera, that this -- one can't help escape that we may be sort of peaking in some of these concerns for the industry and there may be some alleviation of pressure for reasons that they don't have much control over, but nevertheless, kind of work somewhat to give them some relief.

Does that make sense?

MaryEllen McGuire: On the tuitions front, tuition is something that the President is very interested in. It's something that he talked about in the state of the union. It's something that he personally wrote into his speech when we passed the Student Aid Fiscal Responsibility Act in March.

I think tuition will be the next big thing that you see out of the administration. Since I'm part of those conversations, I can't discuss that. So, I think you're going to see some pressure there as well.

The administration will not go back on its Pell Grant increases; it is their signature issue. It's their signature accomplishment in higher education. But, again, we all know what the budget looks like and traditionally there have been Pell Grant shortfall every year; that is nothing new. I worry about the Congress's ability to actually make up those dollars so we can meet the targeted numbers.

Chuck Gabriel: Right.

MaryEllen McGuire: This it's a little too difficult --. I think you're right. I think they may not see the increases that they want if no other reason than there will continue to be shortfalls that they cannot fund. There are shortfalls, obviously, for two reasons. Well, the fact that we're not forecasting correctly, but there are many more people eligible, a, because their incomes are going down and, b, more folks go back to school in recessions.

Shawn Crawley: Thank you.

MaryEllen McGuire: I think it'll continue to conflict. I think we'll know more in a few months in terms of where the President wants to go on tuition. And how that affects all of this -- it could be a bit of a mess initially.

Chuck Gabriel: Operator?

Suzi Stein: MaryEllen, there was a question that was actually emailed to me that I will go ahead and ask. But the question is, the data is all backwards looking. The nation's been in a recession and the economy is not picking up and the likely impact will be strengthened by the time the rules are implemented. How is this taken into consideration? What are the forecasts of the change and the impact?

So I guess, are they considering -- as they're looking at these thresholds, are they considering the fact that unemployment is high and the nation's in a recession?

MaryEllen McGuire: It certainly was a part of a lot of the conversations that came up on the Department of Education phone call yesterday, when someone asked about looking backwards.

The department had to do its best with what it had. I think there's recognition that, again, we may -- we don't necessarily know what the impact is because we don't have a lot of real numbers and because it is looking back, but it will always be looking back the way that it's written.

Certainly if two, three years from now, if the rule isn't fitting in a way that they intended, they could certainly go back and change it. I don't think that's off the table by any means. You can always re-regulate. They have what they have; they have to work with it. It's not a ideal.

Suzi Stein: I had another question about that. If you look at the demographics of Missouri versus the US and the white paper that was put out by the department, I think one of the noticeable differences is in the kind of just the racial differences between the minority versus the United States. And given that you have a large number of minorities at the for-profits, the outcomes and what they find in reality versus the profit data could be very different. Was there a lot of discussion around that particular issue?

MaryEllen McGuire: That was something that came up, but again, unfortunately, it's one of those things where we had to go with the data we had. I think it's -- that is one of the things that's really catapulted the department to put all the data that they have out there, so people can continue to do analysis because they know that they are in the same pieces. They know that it's not the best proxy, necessarily, because of the racial differences in particular, but it's all the data that we have.

Suzi Stein: Okay. Operator, is there another question?

Operator: Yes, ma'am. We do have a question from [Steve McKay].

Steve McKay: Yes, hi, thanks for the call. Just -- there was a comment yesterday on the call about how they're measuring the repayment rate and it sounds like it's just whether the principal is basically $1 lower at the end of the year versus the beginning of the year.

It seems to me that that could be a number that could be manipulated or I guess managed, similar to how the cohort default rate has been managed. So I'm curious, how did they come to that definition? What's the difficulty in just looking at who is in -- currently in repayment, say, at the end of the period? Who's currently paying versus using that measure of just $1 lower?

MaryEllen McGuire: Yes. It's -- this is another one, it's not unlike those runs that I spoke about, where the department just had to make a bit of an judgment call. I would imagine that this is -- I think, James -- I think it was James on the call yesterday that said this is an area where they'd like to hear more from folks.

He specifically went for the repayment rate over default rate because default rates really aren't much of a measure of anything. You can stay out of default by just keeping in contact with your lender; you're not actually paying any sort of principal back, necessarily, at all, never mind meeting your interest.

It was -- I can't really give you much more than it was just a judgment call, at the end of the day, that we would look at the dollar as something that they can -- that they feel that they can manage through their records. And, yes, I think, people will manipulate it, and yes, I could imagine it will -- for-profits will find a way to make sure that they're getting folks just to that dollar.

I think whatever amount they put on -- it could be a penny, it doesn't have to be a dollar -- there's always room for people to game the system, but at some point you have to make a decision.

Steve McKay: Great. Thanks.

Operator: We do have a question from [John Selenez].

John Selenez: Hi. Thanks for taking my question. With regard to lead generation, can you share what the administration views were on this industry? Also what you think the intended impact of some of the changes during negotiated rule making are vis-a-vis the elimination of the safe harbors into new language?

It's my understanding the industry operators think there's really no change in that continuing to gather contact information and sell those leads to the for-profits is acceptable and not a violation, even with the elimination of the safe harbor. Thanks.

MaryEllen McGuire: Yes, I mean, I -- the administration thinks that they are putting the dents in all of that. They -- I think they would disagree with what some of the for-profits are saying. Of course, this is an industry that has proved to be brilliant when it comes to gaming the system.

In terms of sort of what the administration thinks of the industry in general, I think it is really important to say that the administration cannot reach their 2020 goal without the for-profit industry. The President's goal is to have the highest proportion of college graduates in the world by 2020; that is impossible to achieve without for-profits. So it's not (inaudible) against the for-profits, it's about bad actors in general.

These rules don't apply just to for-profits they just proportionately apply to for-profits. But again, it is -- it was Congress's decision to decide which institutions fall under this particular requirement.

John Selenez: Okay. Great. Specific to lead generation, any specific thoughts to that industry? It seems like a lot of the leads and starts and enrollment generated by the industry -- in the for-profit industries, derive from lead generation and it's kind of a derivative away, but is that something that is intended to be increasingly regulated?

Because, for example, to my understanding, they typically get compensated based upon conversion rates. I guess one could view that as indirectly being compensated on ability to secure enrollments. But the industry, I think, is operating under the assumption that the practice has not been restricted in any way by elimination of the safe harbors.

MaryEllen McGuire: Yes, I think this is one of those things that's going to come up in public comment and the department is going to have to take a position on to be very, very clear about it.

I think the -- I mean, there probably is still wiggle room, whether or not the department feels that way right now. If it does come up in public comment though, I would imagine this is something that they will have an opinion on and they will incorporate into a final rule. If it doesn't come under public comment, they can only work off the public comments in terms of making changes to this rule. It may just become the next thing that they look to over the coming year.

John Selenez: Okay. Thank you.

Operator: There are no further questions.

Suzi Stein: Okay. I want to thank MaryEllen and Chuck for participating on the call, and thanks to everyone who listened. There will be a replay of the call beginning at two o'clock today, going through August 19th, and the dial-in number for that is 800-642-1687 and the conference ID number is 94191313. Thank you very much.

Operator: Ladies and gentlemen, thank you for participating in today's conference call. You may now disconnect.