Career College Association

A Response to Steven Eisman

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In a recent speech in New York and in testimony submitted for tomorrow's Senate HELP Committee hearing, Steven Eisman, a portfolio manager at FrontPoint Financial Services Fund, castigated the private sector higher education community, making an absurd comparison to the subprime mortgage industry. Mr. Eisman is a noted short seller, accorded recognition for his role in predicting the collapse of the subprime mortgage lending marketplace. A short seller is someone who makes money when stock prices of publicly traded companies drop, often precipitously.

Given their role in predicting such declines, short sellers are modern Cassandras, constantly warning of economic doom and gloom. Just like stopped clocks, once in a while they are right. To the extent that through careful review and analysis of facts they draw attention to fraud, abuse or other miscarriages of investor trust, they perform a useful watchdog service.

When they cross the line, however, and exaggerate, exploit or even invent information to raise doubts, short sellers are an impediment to properly functioning markets and harmful to shareholders and stakeholders alike. When among the stakeholders are a population of working adult and lower income students, many pursuing higher education for the first time in order to achieve better lives for themselves and their families and benefitting our country's economy, particular care should be given to the line between vigilance and vitriol. For whatever reason, Mr. Eisman not only crossed it, he ignored it altogether.

How so? Comparing the for-profit career college sector to the subprime mortgage banking industry is as silly as it is simplistic. In the case of the latter, mortgage broker companies, many that came from nowhere and soon disappeared to the same location, originated loans among many unqualified applicants. The loans were then bundled and sold on securities markets to buyers with little or no knowledge of the underlying paper. Those who were tasked with evaluating the securities ignored their fundamental responsibility. A housing bubble fueled this otherwise illogical and ill-advised series of transactions. In a market producing double-digit year on year annual housing price increases, home buyers had little reason to question their ability to repay loans, brokers had little

reason to question the buyers' ability to do so, and investors had little reason to question the integrity of the securitized mortgages. Take away the bubble, and the fantasy of no-risk, widely shared subprime mortgage lending evaporates.

The higher education dynamic is very different. First, there is no bubble to stimulate irrational behavior. No one questions the need to increase the number of students with postsecondary degrees, as it benefits the U.S. economy generally and the students individually. In fact, increasing educational opportunity and solid outcomes is essential to this country's economic future. Most students in career and professional schools use federal loans and grants, but the lent portion must be repaid. The value of the student investment grows over time, but this happens the old fashioned way: students earn it by gaining the credentials and necessary skills, applying those skills in early stage jobs, and climbing the career ladder. And education, as we all know, lasts a lifetime.

Secondly, the institutions providing the education are not no-name entities, with no future reputation to protect. On the contrary, they are accredited institutions, licensed by the state or states in which they operate, regulated by the Department of Education. Most have a long track record in their respective communities. The accreditors are small, not for profit entities, not Wall Street behemoths like those who rated the subprime securities, and had no reason to ask tough questions. The accrediting reviews are done by competitors of the schools they are reviewing, who have every reason to question schools that cut corners, and, in turn, are subject to oversight by the US Department of Education.

Third, unlike subprime mortgage lending where loan underwriting was largely missing in action, career colleges do "rate" prospective students in terms of their chance of success. Contrary to the impression that Mr. Eisman tried hard to create, institutions have little incentive to fill seats with students who cannot succeed academically. For one thing, if the students drop out soon after enrolling, the schools have to return to Uncle Sam any government supplied/backed funds the students received and then used to pay for their education. Nationally accredited colleges and universities must meet specific

outcome metrics for retention/graduation and placement to retain accreditation and Title IV program eligibility.

Beyond accreditation, damage to reputation is also a highly effective check on institutional quality. Career education is a word of mouth business—especially when those words flash around the Internet in milliseconds. Those institutions with shoddy educational offerings, unqualified students or high drop-out rates quickly find themselves enjoying diminishing returns.

Fourth, career colleges have a stake in the success of the student because they themselves are graded on outcome metrics. Failure to achieve specific metrics flunks schools out of the Title IV student aid programs. Mortgage brokers had no such stake in the success of borrowers at home ownership and paid no penalty when buyers defaulted on their home loans. The lenders themselves had little risk because they securitized their loans.

Mr. Eisman correctly notes that the size and significance of career education is growing rapidly, but this is so for reasons that have nothing to do with the irrational exuberance of an overheated market. Just the opposite. The higher education landscape is changing because it must change. For most of its history, higher education has been the domain of the privileged few. While from to time, the government has made dramatic interventions to provide access to a broader swath of society, such as the Morrill Act of 1862 establishing the land grant colleges and the original GI bill which allowed millions of returning veterans to get a college degree, today's traditional colleges and universities are once again primarily the province of the economic elite. In a global economy and a u-shaped recession, educational elitism is a prescription for disaster. The consequences of not changing, of allowing the American middle class to shrink and the lower classes to grow, are simply untenable.

The emergence of the non-traditional student in higher education is one of the great untold stories of the day—a triumph of enlightened public policy leadership. Over 2.8 million students will attend career colleges this year. They will pursue education in more than 500 fields at over 2,900 accredited institutions. And nearly half of them will do all of this while raising children, because 47 percent of

our students are parents. They are on average 28 years old, not immediately embarking on their educational track upon high school completion. Additionally, the majority of these students are the first in their family to pursue higher education. Five percent are veterans.

Career college students are very different from traditional college and university students and the education they require tends to be very different. In form, career college education is tailored, streamlined, flexible, and outcome oriented. It is designed to meet the needs of working, independent adults. Course schedules are aligned to assure access and availability, and course offerings are often presented in a limited, sequential manner. This means that students do not experience long wait times to enroll in a specific class or program, or worse, they do not waste months or years spinning their wheels in poorly defined or ill-fitting majors. Although classrooms and textbooks play a role, the pedagogy is designed to aid the adult learning process by being immersive, hands-on, practical, informed by area employers and shaped by real-world work requirements.

These are innovative processes and methods delivered to a new type of college student at a time of dramatic change, at time when effective, outcomes-based education is badly needed by students, employers and communities alike. Federal loans and grants provide access to that education and, by doing so, make an affirmative investment in working class adults, social mobility, and the U.S. economy overall. Mr. Eisman cites what he believes is a traditional relationship between matching means and cost in education. Using his "traditional relationship," we should continue to support the idea of having the poorest neighborhoods generally having the worst in terms of public school facilities and the fewest resources.

I firmly reject his elitist approach to education, both as a social scientist and as one who personally came from very modest means and was able to advance primarily because of the educational opportunities I received. And I reject it on behalf of the tens of millions of Americans who are willing to work hard to get ahead and who deserve a choice on how best to do so.

Sending economically disadvantaged college students to the lowest cost public colleges, he says, would maximize the return on Title IV grants and loans. One important point Mr. Eisman does not understand is that no one "sends" students anywhere. They have choices, and if they choose to attend a career college over a community college or four year school—or not go to school at all--they are doing so in a very competitive environment.

But even if one did want to "send" low income and working adult students to only the lowest cost schools, that would not maximize outcomes from the viewpoint of students or taxpayers. Students graduate from two year career college programs at three times the rate of community colleges. Private sector schools treat a student as an individual, not a number, and determine what interventions are necessary to make that individual succeed. Community colleges are less successful in dealing with at risk populations because, like the secondary public school system, even with a substantial public subsidy, they are resource constrained and therefore must rationalize educational outlays per student. Far from maximizing every dollar, the government's own data on community college graduation rates suggests that this approach diminishes the individual's higher education opportunity and chances of success.

Mr. Eisman ignores this inconvenient truth and points to the fact that private sector colleges and universities account for about 10 percent of enrollments but over 20 percent of federal grants and loans. Again, this is misleading. By focusing only on Title IV funds, Mr. Eisman obfuscates the fact that not-for-profit schools receive billions of dollars in other government funding. In 2007 alone, federal, state and local governments awarded colleges and universities $142 billion in grants, contracts and appropriations. Private sector schools received only 1% of these funds. On a blended gross basis (i.e. not discounting for loans repaid), private sector schools receive only 6% of government education funding – significantly less than their 10% share of the student total.

Mr. Eisman raises other important questions, including the amounts our institutions spend on actual instruction and the value of a career college education. In terms of the former, the percentages spent by traditional and

private sector colleges and universities is not substantially different, ranging from 32 percent at private liberal arts colleges to almost 23 percent in our sector. Why the difference? Much comes from the fact that our faculty is not tenured or cloistered. Our instructors tend to be subject matter experts and in field professionals who love to teach rather than teaching professionals per se. That fact, combined with an emphasis on producing specific educational outcomes for students rather than pumping up specific egos for academics, explains much of this variation.

Now let's take Mr. Eisman on value: "What do these students get for their education? In many cases, NOT much, not much at all," he claims. Everyone is entitled to his own opinions, but not his own facts. And the facts contradict his assertion. Unlike traditional college counterparts, nationally accredited career colleges must meet certain placement outcomes to remain Title IV eligible. Nationally accredited schools do so at a rate of 70 percent, even in a difficult economy. Career college graduates realize an immediate salary "bump" as a result of their degrees. The median annual earnings of a high school graduate are $30,316. The weighted mean of earnings by education level as distributed among career college completions is $39,546, a difference over high school of $9,230. Assuming a total two-year career college investment of $29,533, the graduate's ROI is 31.25 percent. Students who have programs of study at private sector schools that require post graduation examinations, such as nursing, test just as well as students who graduate from traditional schools.

Mr. Eisman expresses concerns about cohort default rates but in so doing fails to provide the appropriate context and in some cases simply misstates the case. A college education is a significant buffer against unemployment. The current unemployment rate of those with only a high school degree is 6 percent higher than that of those with a baccalaureate degree. Still, the economy has a significant impact on the ability of graduates to repay their student loans. Default rates rise when the economy falters and fall when the economy recovers. As a result, cohort default rates are a significant concern for all institutions, not just career colleges, particularly in an environment marked by 8 percent unemployment for new college graduates.

But the simple fact is, as the Government Accountability Office (GAO), the Congressional watchdog, testified last fall at a House hearing, schools that accept lower income students will have higher default rates—regardless of the school's tax status. The default rate is related to the default risk factors, including student characteristics associated with ability to repay.

The cohort default rate for fiscal year 2007 students at career colleges (referred to as proprietary institutions) was 11 percent compared to 5.9 percent for students at public institutions and 3.7 percent for students at private non-profit institutions. If the reported rates take into account the profile of borrowers and defaulters, the cohort default rates for for-profit students differ only slightly with those of community college students (9.9 percent) and are comparable to students attending Historically Black Colleges and Universities (11.5%), whose student demographics are similar to career colleges. While no level of default is acceptable and the career college sector, in concert with the Department of Education, works to improve default prevention strategies, perspective yields understanding.

The truth is that the overwhelming majority of career college students graduate and repay their student loans. Suppose, however, that efforts to rein in the default rate are unsuccessful and the percentage of defaults continues to climb, say to the Department of Education's projected 21.2 percent rate over ten years. On a $500 billion federal loan volume, that is $106 billion, about one-seventh of the $750 billion the federal government will pay in welfare this year. Or to consider the converse, 80 percent will repay notwithstanding the fact that these are loans made to the economically disadvantaged, removing many from the welfare rolls. According to the federal Office of Management and Budget (OMB), the repayment rate for federal Title IV student loans has actually been rising sharply for more than a decade and has almost doubled. Currently, including penalties, interest and fees, the federal government actually collects 122 percent of the total amount of student loans it makes.

Career colleges are better than traditional institutions at retaining and graduating the very students that Mr. Eisman claims he is concerned about: minority

students, low-income students, first-generation students and at-risk students. More than half of students attending two-year private sector colleges have at least three risk factors, compared to 39 percent of community colleges students. Four-year career colleges whose student populations are at least 60 percent low income have a much higher graduation rate than their traditional counterparts, 55 percent compared to 39 percent for private non-profit institutions and 31 percent for public institutions.

Mr. Eisman accuses career colleges of being marketing machines masquerading as universities, another audacious claim. His evidence is a single disgruntled employee. There are well over 200,000 employees in the career college sector. There is no excuse for high pressure recruiting tactics. Although the approach to student recruitment in an open admissions environment is likely to be very different than in a very competitive admissions environment, the law says enrollment can be just one factor in incentive compensation. As a result, there are simply no enrollment-driven paydays for admissions personnel nor do career colleges spend inordinate amounts on recruitment activities. Indeed, private for profit mean marketing costs per enrollment are $2,538 compared to $2,366 for traditional institutions. Another recent study by the GAO finds scant evidence of incentive compensation violations, 32 episodes between 1998 and 2009, and 13 of these pertained to traditional colleges and universities. The limited cases draw lots of attention, but the point is the cases are limited.

Mr. Eisman raises the canard about national versus regional accreditation, the latter being more valuable and/or rigorous than the former. He likens accrediting agencies to rating agencies in the subprime mortgage example and criticizes the peer review nature of accrediting bodies. The “inmates run the asylum,” he says. If so, inmates run the asylum in such fields as medicine, law, dentistry, and veterinary science. Far from being the type of hand-in-glove arrangement that Mr. Eisman suggests, the peer review process in national accreditation is rigorous, performed by competitors with plenty to lose if schools are allowed to color outside the lines. Also, accreditation agencies are overseen by the Department of Education.

Returning to his wrongheaded subprime mortgage analogy, Mr. Eisman says for the investment case against the industry to work requires the government to do something, and the Department of Education needs to do "everything and anything to deal with this industry." What he really means is that for the short sellers to make money, the triad of higher education overseers—Federal and state governments and accreditors—has to make bad policy/enforcement decisions based on anecdotes, not facts. For everyone else, especially the students, bad policy, such as the Department's proposed new regulation on gainful employment, would be a disaster.

The case against the gainful employment proposal is compelling. The proposal calls for an student loan debt to income ratio be no higher than eight percent. The proposal has no basis in fact, reason or economic analysis. A College Board report done in 2006 rejects the eight percent notion. They note that "the percentage of income people can afford to devote to loan repayment increases with income." The College Board authors, Sandy Baum and Saul Schwartz, did not choose one percentage as the preferred or correct number and, in fact, concluded that programs such as Income Based Repayment, strongly supported by the Obama Administration, are the best debt management tool. The College Board report found five distinct weaknesses in the use of eight percent as a debt-to-income ratio.

In the absence of Departmental data to support its gainful employment proposal, CCA commissioned its own study. This research, based on an analysis of more than 10,000 programs involving over 600,000 students in 45 states, and performed by Dr. Jonathan Guryan of the University of Chicago and his colleagues at Charles River Associates (CRA), demonstrates that the Department's hypothesis about limited impact on postsecondary education is false and the unintended consequences enormous. Moreover, one would expect that programs that failed the 8 percent debt-to-income ratio test would have higher default rates than the programs that passed the test, but it was found the reverse is true. The Department's Gainful Employment proposal would shrink substantially access to postsecondary education, eliminating programs in a wide range of high demand

areas, such as healthcare, IT, and education. A high level summary of Guryan-CRA study findings indicates:

- Over 300,000 students displaced
- Upwards of 2,000 programs eliminated
- 40 percent of students in two- and four-year programs harmed
- 14 percent of health professional and related clinical sciences programs, including nursing would fail
- 19 percent of computer and information sciences and support services programs would fail
- By 2020, the proposed regulation would *deny access to approximately* ***5.4 million students*** on track to attend programs at for-profit postsecondary institutions, based on projected enrollment rates.

With many community and state colleges losing capacity, this means that Mr. Eisman's suggestion that students attend these institutions is itself untenable. How can our country meet President Obama's goal of graduating an additional 10 million students and make room for 5.4 million students that would be displaced from career colleges? It can't.

Rather than impacting a small number of high cost programs, which is what the Department asserted would happen during the negotiated rulemaking sessions in January at which the gainful employment proposal first got a public airing, the research demonstrates that the proposal stands to harm a large population of students across many fields of study and runs contrary to the Administration's efforts to create more capacity in higher education.

Mr. Eisman says a simple solution exists to address the gainful employment question: institutions just need to lower their tuitions. The Gainful Employment proposal would indeed function as a tuition cap, but schools would not be able to reduce tuition to comply with its terms. Instead, they will need to shut down non-GE compliant programs. First, under the 90-10 rule, schools cannot receive more than 90% of their revenues from Title IV funds. Thus, if a student is permitted to borrow $10,000 for a particular program, a school will not be able to set tuition below $11,111 without risking a violation of 90-10. If this program should fail the GE test at $11,111, the school would be forced to shutter the

program rather than reduce tuition. Second, students are entitled to borrow up to the federally-mandated loan limits, regardless of tuition price. Schools are not permitted to limit borrowing to tuition costs. Thus, tuition reductions will not necessarily reduce the amount borrowed.

It's also important to note that our institutions, not subsidized by the federal government, rely on tuition alone to fund capital investment, program expansion, new technology, new campuses and to keep their education offerings at the cutting edge of the marketplace. So long as the need is there, we believe that not only a reasonable alternative but the best alternative is to use this surplus to make career education both widely available and as relevant as possible to current and future employer needs. To do otherwise is to do as resource constrained traditional colleges and universities must do: cut programs, curtail services, limit access.

Higher education stands at a crossroads. It can rally as it has done in the past to help new generations of American workers meet the challenges of a changing economy. It can serve as the portal to those who live not only in my zip code, but in every zip code to gain the skills and abilities needed to compete and to add value in an ever more demanding work place. And it can adapt its processes and methods to facilitate postsecondary efficiency and effectiveness by eliminating legacy barriers and philosophical constraints.

Or it can insist on retaining the status quo, continuing to enable a situation in which half of American workers have no college credential, where half of college students never graduate, where educational inputs trump outputs…where higher education itself becomes not the means of upward mobility but the club closed to membership for all but the most academically or economically gifted.

It is no secret that the career education sector is under attack by short sellers, trial lawyers, self-styled consumer advocates, and some traditional academics. Although they should know better, these critics use anecdotes to generalize and to make sweeping condemnations of our sector. They seize on admittedly flawed government data to make the most extreme statistical arguments. They exploit the same small cadre of so-called third party experts to generate critical

comments. And they recycle old news to give currency to new allegations. In short, they twist the truth to serve their self-interest.

Can career colleges improve? Yes, and they work every day to do so. After all. They have the "triad" watching them. And Congress. And the GAO. And the media. And the short sellers. And the trial lawyers. But, most importantly, they have their students coming to their schools every day with high expectations about how these schools are going to improve their lives, put them in a better place, provide real return—financial and personal—on their investments. And they better deliver, because these students have choices.

America's non-traditional student, returning to higher education, raising a family, working nights and weekends to make ends meet, does not have time for Animal House food fights. Higher education in this country is changing, and the non-traditional student is the change agent. We can stand in the way and be marginalized, or we can change the way we think, talk and act towards the players in higher education; embrace all avenues to a postsecondary education; reject biases that limit our ability to recognize what works.

The way forward seems obvious to me.