

Business & Education Services

Program Integrity Rules Part 1 Are Largely As Expected with Gives and Takes By the Education Department - ALERT

Today, the U.S. Education Department (ED) will release the final Program Integrity rules in the [Federal Register](#). Copies of the final rule have been circulating the investment community since yesterday. This final regulation (Part 1), which will become effective July 1, 2011, addresses 13 program integrity issues, as well as the disclosure/reporting requirements and program approval portions of the gainful employment rule. Recall that the complete, more controversial gainful employment rules (Part 2) have been previously delayed until early 2011.

- **No hint of gainful employment metric easing, but the major provisions are not addressed.** In the brief time we had to study the 894-page document with 80+ mostly small changes, we noted that the ED has signaled only modest room for compromise from its previously-proposed version. The incentive compensation section, for example, eliminated safe harbors, as expected, but still remained unclear about some allowed compensation arrangements for revenue-sharing and lead generation relationships. We continue to believe that the ED is trying to be thoughtful in its approach towards the gainful employment proposal and will attempt to provide additional clarifications.
- **ED shows a reasonable approach.** Notably, this package includes one incrementally more challenging rule (on state authorization of online programs) and two incrementally more amenable rules (on program approval and definition of credit hour). The ED showed its desire to control online growth by requiring online institutions be authorized in all states where they are offering instructions. We think the impact may vary quite a bit among the education services companies. For example, STRA (which offers both campus and online education) noted that less than 5% of its students live in areas where STRA is not authorized by a local state (STRA is authorized in 20 states). On the other hand, fully online institutions like CPLA and BPI may face more evident challenges. On the positive side, the ED was willing to concede to the industry's protests against it being involved in the approval process for new programs; the ED would only require a 90-day notification instead. In addition, the ED has revised the definition of credit hour to allow schools to determine the appropriate credit hours and equivalencies.
- **Potential Republican majority in the House (and possibly the Senate) after the Nov. 2 elections should lower Washington risks for the for-profit education services (4PES) sector.** The Republicans historically have been more understanding towards the 4PES sector. As a result, we believe that 4PES industry will seek congressional action or litigation to reach a more balanced approach.
- **Please register:** November 9, 2010, New York City: J.P. Morgan Ultimate Services Conference will feature a dedicated Education Services track. We will also host a Education Regulatory/Legislative Panel of experts who will discuss this regulation.

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Ultimate Services Conference

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North America Equity Research
29 October 2010

J.P.Morgan

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