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Reversing the Department of Education's Anti-Market Orientation in Higher Education

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KEY TAKEAWAYS

The U.S. Department of Education has expressed an anti-market bias, standardizing postsecondary education instead of unleashing market competition to improve it.

So long as it exists, the department should be limited to such roles as reducing barriers to innovation and improving data collection.

Third-party servicers are vital to institutions' ability to innovate. The discipline of the market and the courts should be preferred to bureaucratic meddling.

For two decades, during the tenures of the Obama and Biden Administrations, the Department of Education has tried to curtail access to for-profit colleges and universities (known as the "proprietary" sector in higher education) through a growing tome of federal regulations.[1] Oversight of the nonprofit and public sectors has been much slower in coming. Indeed, rather than cast a critical eye at the return on investment of traditional higher education, the Biden Administration is pursuing every possible avenue for student loan debt amnesty, a massive handout to nonprofit and public colleges and universities. Rather than singling out the for-profit sector, which is meeting the needs of non-traditional students in particular, the department should hold all sectors to the same standards instead of expressing the anti-market biases described in the following.

Furthermore, while it continues to exist, the department should strive to encourage innovation in postsecondary education. Nascent technology companies—in whatever ways they intend to serve postsecondary institutions—cannot easily take the financial risk of building partnerships when the department's regulatory regime stifles them and threatens their finances. Instead, the next Administration should rescind many of the anti-market regulations promulgated in recent years.

Summary of Anti-Market Regulations Under Secretary Cardona

The U.S. Department of Education, under Secretary Miguel Cardona, has taken a heavy-handed approach against for-profit enterprises in postsecondary education, whether those enterprises are institutions or simply for-profit partners of nonprofit institutions. This *Backgrounder* summarizes the policies that have been explained in more detail elsewhere.

"Gainful Employment." The Higher Education Act defines a proprietary (for-profit) institution primarily as a "school" that is neither public nor nonprofit and "provides an eligible program of training to prepare students for gainful employment in a recognized occupation."[2] From this one reference, the department has produced a significant cascade of "gainful employment" regulations. These rules set alumni income and debt standards almost exclusively for proprietary institutions. Meanwhile, the agency has not produced similar regulations to hold public or nonprofit institutions accountable for the outcomes of their students. Gainful employment regulations were promulgated under President Obama, but the Trump Administration rescinded them, correctly arguing that the set of regulations "wrongfully targets some academic programs and institutions while ignoring other programs that may result in lesser outcomes and higher student debt."[3] Yet the Biden Administration has brought them back in very similar form.[4]

"Borrower Defense." The Higher Education Act authorizes the Department of Education to "specify in regulations which acts or omissions of an institution of higher education a borrower may assert as a defense to repayment."[5] Since the 1990s, such regulations have focused on "any act or omission of the school attended by the student that would give rise to a cause of action against the school under applicable State law (the State law standard)," and only 10 claims were recorded prior to 2015.[6]

But the "borrower defense" regulations today extend far past the department's authorization to describe possible defenses that a borrower may assert against repayment. A traditional borrower defense would be, for instance, that an institution intentionally misstated material information about future employment prospects or the license required to accompany a degree in order for a graduate to be allowed to work in a state. But the department has also asserted its own authority to "initiate a proceeding to collect" loan amounts from the school on behalf of the student even in the absence of a successful claim in court.[7] Once the department successfully collects the funds, it cancels the student's debt. These regulations make the department judge, jury, and executioner in order to cancel student loans and claw back student aid funding.

During the Obama Administration, the department went a step beyond its alleged authority to "collect." The department required institutions to have the money available just in case the department came to collect it. This requirement took the form of astronomical letters of credit (certifications from banks that the money would be provided, if needed), which successfully knocked proprietary institutions out of the education market.

As of November 2015, the largest outstanding letter of credit was for $217.5 million against the Education Management Corporation, owner of Argosy University and other institutions.[8] The judicial system had already worked successfully for Argosy students with claims prior to the department's intervention.[9] But most for-profit universities have had no major claims or investigations like Argosy's. As of November 2015, about two of every three of the department's required letters of credit over the previous five years—1,800 out of 2,700—were against for-profit colleges.[10]

For-profit institutions have endured regulatory whiplash from one Administration to the next. Under Secretary Betsy DeVos, the department generally returned the regulations to their pre-Obama form, but under Secretary Cardona, the borrower defense rules became more punitive than ever. For example, the department gave itself the ability to reopen "at any time"—meaning forever—a borrower defense application that was denied, and the rules now ban recruiting tactics that are normal marketing in other sectors of the economy.[11]

"90/10" Rule. The American Rescue Plan Act of 2021 required that each proprietary institution "derive not less than ten percent of such institution's revenues from sources other than Federal funds"—that is, no more than 90 percent of a for-profit institution's funding may be from federal financial aid.[12] In late 2022, the department significantly changed the rule to make compliance with the cutoff more difficult, changing the definitions of the required inputs. The new rule expanded the kinds of federal funding that would count for the "90" part while restricting the kinds of nonfederal funds that would count for the "10" part, making the ratio harder for institutions to meet. For example, in the "10" part, non-federal dollars must now come from programs that meet a variety of new requirements, such as being taught in person—distance education programs are now excluded.[13] No such rules apply to nonprofit or public colleges.

Other Administrative and Financial Rules. Accreditors maintain most of the responsibility for vouching for the academic quality and other characteristics of institutions of higher education in order to qualify them for federal financial aid programs. But the department maintains oversight in the areas of institutions' "financial responsibility" and "administrative capability."

The department once again reinterpreted such statutory terms broadly in order to shoehorn regulations designed primarily to attack proprietary institutions. For example, the department's new rules in 2023 tie "administrative capability" to the new gainful employment regulations, making a college ineligible for federal student aid programs if more than half of its students are in programs that fail the new gainful employment standards or if more than half of the college's revenue comes from such programs.[14] The new "financial responsibility" rules more strictly enforce elements of the new gainful employment, borrower defense, and other new departmental regulations by making alleged failures in these areas "mandatory" rather than "discretionary" grounds for departmental investigation.[15]

Third-Party Servicers: A Case Study

Many colleges and universities use for-profit services to accomplish their nonprofit missions. For example, online education must be nimble as student needs evolve, yet creating quality online programs from scratch is expensive. Nonprofit institutions can save money and maintain quality by outsourcing much of this work to online program management (OPM) companies.

In 2023, the department hastily reinterpreted its definition of third-party servicer (TPS) to regulate a much broader set of entities and arrangements between institutions and their various academic and nonacademic partners. The department's lawless abuse of process and statute in this area is instructive. The department announced the new TPS definition without required rulemaking—simply issuing a "Dear Colleague" letter on February 15, 2023, and asked for comments. This letter showed that the department was again exceeding its statutory authority, which is limited to TPSs of student aid programs. Instead, the rule would have swept in many more entities beyond OPMs, extending so far as "a hospital, clinic, or private medical practice providing clinical experiences for medical and nursing students" or "a local police department helping to compile and analyze campus crime statistics," as the American Council on Education noted at the time.[16]

Such dramatic regulation of institutions' for-profit partners is ill-suited to the rapid pace of innovation in postsecondary education, where proprietary institutions and partnerships drive progress—particularly in low-cost access to curriculum through systems that keep up with technological innovation faster than campus bureaucracies normally move.[17]

The department's bias against profit took precedence over student service. But backlash from traditional nonprofit institutions was swift. On March 29, on behalf of more than 80 higher education organizations, the American Council on Education opposed the department's aggrandizing of power.[18] The department backtracked on implementation of its new rule, delaying it indefinitely. However, as of early 2024, the department had still failed to rescind it, signaling that it could revive the new definition at any time.

After the Middle States Commission on Higher Education (MSCHE), a higher education accreditor, proposed its own TPS rules, higher education policy experts who had worked under Secretary of Education Betsy DeVos became "concerned that MSCHE is attempting to short-circuit the Department's process and unilaterally impose the withdrawn [Dear Colleague letter] on its member institutions under the guise of its accreditation criteria."[19] In their letter to MSCHE, the policy experts warned that the department's new TPS definition was overbroad and that "any definition that sweeps more broadly than existing law is likely to increase students' costs and stifle innovation in postsecondary education." Furthermore, new regulations or accreditation requirements in this area would "privilege early adopters and discourage new partnerships."

For-profit enterprises are already disciplined by the market if their products or services fail to deliver more than available alternatives, and the courts remain open to discipline bad actors. Market discipline serves to increase access, improve the student experience, and reduce costs, while federal regulations need not supersede laws enforced by courts. These points caution not only against the department's overregulation of TPSs but also against the department's overregulation of for-profit enterprises generally.

Policy Recommendations

Reorientation of the Department of Education away from anti-market regulation, leaving education markets open for innovators, would help protect the exploration of new and better ways to serve students. So long as the department continues to exist, reforming it in this way would provide a small step toward leveling the playing field between private and public operators. Specifically:

- **The department should rescind its overbroad, limiting, punitive, and hastily considered regulations and guidance designed to attack market actors and limit market forces as described above.** This work entails rescinding gainful employment, returning borrower defense and TPS regulations to their statutory limits, and restoring the previous parameters for 90/10 and financial and administrative capability regulations.

- **Given the department's demonstrated lawlessness, Congress should prohibit the department from regulating in any area without its permission.** This point applies across the board, from the department's regulations on Title IX due process protections to its regulation of for-profit enterprises and partnerships as described in this *Backgrounder*. The gainful employment and TPS definitions are perhaps the most important to keep within congressional, rather than departmental, control. Section 303 of the College Cost Reduction Act, limiting the authority of the department to propose or issue regulations and executive actions, expresses such a policy well.[20] At the same time, deregulation should generally be an exception to this policy. A return to the DeVos-era regulations, any provision that lifts burdens on regulated parties, and any provision that restricts the definition of a regulated party should be exempt.

- **The department should maximize its waiver authority to permit innovation among the largest possible number of regulated entities.** A key route to this goal is to maximize "experimental sites" authority, which provides targeted regulatory relief to colleges and universities in the area of accreditation rules. An experimental site program waives one or more accreditation rules for participants as they experiment with different ways of demonstrating academic or administrative quality. For example, Section 313 of the College Cost Reduction Act would let an institution—for-profit or not—avoid accreditation entirely (whether for the whole institution or for one or more of its academic programs) so long as it shares financial risk with the department.[21]

- **Congress should prohibit the department from being judge, jury, and executioner in the enforcement of its own rules.** Cases of fraud should be left to the courts and the Department of Justice. States and accreditors should have more responsibility than the department in determining college quality and student outcomes. As much as possible, the department's accountability role should be limited to data collection and transparency.

- **Any outcome-based standards in higher education at the federal level should be determined solely by Congress and should apply equally to proprietary and non-proprietary enterprises.** Absent such federal legislation, the department should apply regulations equally and should not treat colleges and universities differently because of their tax statuses.

- **Congress and the department should make it easier to become an accreditor, should make it easier for innovative educational models and institutions to be approved by accreditors (such as via "experimental sites"), and should ensure that any institution may choose any relevant and recognized accreditor.** Congress should also prohibit accreditors from abusing their power to affect institutions' eligibility for federal student aid programs. That entails requiring accreditors to certify eligibility only on the basis of criteria stated in the Higher Education Act rather than adding ideological criteria such as "diversity" requirements—which is another policy advanced by the College Cost Reduction Act.[22]

- **Congress should take a market approach to student loans.** First, until student loans are entirely privatized, Congress should defederalize student loans by repealing the provisions of the Health Care and Education Reconciliation Act of 2010 that centralized student loan issuance in the department and priced private banks out of the market for issuing student loans.[23] Second, Public Service Loan Forgiveness should end, because it treats private-sector professions as second-class to nonprofit and government work.[24]

Conclusion

The U.S. Department of Education is doing the opposite of what it should: It standardizes education instead of unleashing market competition to improve education. So long as it exists, it should be limited to such roles as reducing barriers to innovation, improving transparency, preventing accreditors from abusing their power, and improving data collection.[25] Whether institutions use third-party servicers or are themselves proprietary, the discipline of the market should be preferred to bureaucratic meddling.

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Endnotes

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