



VETERANS EDUCATION SUCCESS

The ITT Collapse: Lessons Learned and Dealing with Future Challenges *October 2016*

The 2016 collapse of ITT Technical Institutes¹ provides an opportunity to reflect on lessons learned, prepare for the possibility of future implosions of for-profit colleges, and to get ahead of future problems which are increasingly apparent.

Executive Summary

The seeds of ITT Tech's collapse were decades in the making. Deregulation of the for-profit college industry certainly played a role in enabling ITT's increasing dependence on federal dollars, but corporate short-term thinking, greed, consumer fraud, and a failure to learn were the primary causes of ITT Tech's decline.ⁱ At the time of its failure, ITT was so financially unstable that many Wall Street and education experts had predicted its bankruptcy for well over a year.

In addition to its financial instability, the company's very business model was unsustainable in two ways. First, and most obviously, it relied on illegalities that were increasingly running afoul of law enforcement, illegalities that would also bring about its demise. But just as important, although more subtle, ITT's business model could not survive in the business of higher education because it charged tuition that was too high for an education that was too poor in quality and because it relied on deceiving and "churning" through students in order to stay afloat. ITT could not compete in the market of education, and had remained standing only because it was artificially propped up by the federal government.

Thus, when ITT finally died, it came as no surprise to most experts and observers.

Lessons Learned from Corinthian Led to Better Outcomes with ITT

The Department of Education handled ITT significantly better than it had handled the demise of the Corinthian College company in 2015. Department officials noted that they had clearly learned lessons from the Corinthian debacle and that they had listened to the critiques of the Department's handling of Corinthian. Not all government officials have

¹ ITT Technical Institutes ("ITT"), is owned by Educational Services Incorporated ("ESI"). The corporation operated over 130 campuses in 38 states and enrolled students in online programs nationwide. ESI also owns Daniel Webster College.
<https://www.sec.gov/Archives/edgar/data/922475/000119312516503629/d151465d10ka.htm>

open ears or are willing to learn from past mistakes, and the Department is to be commended for taking seriously the critiques of its handling of Corinthian.

In facing problems at ITT, the Department took a very different approach than it had with Corinthian, including:

- Not treating ITT as “too big to fail” as it had with Corinthian;
- Not tying students to another failure factory, as the Department had in shuttling Corinthian students into a new entity created by ECMC and in hiding students’ right to a closed school discharge; instead, the Department encouraged ITT students in their right to a closed school discharge;
- Not engaging in a financial conflict of interest as the Department had in the sale of Corinthian, where the Department had a vested stake of \$17.5 million dollars;
- Putting students’ needs first, offering them speedy closed school discharges and free college and financial counseling from the Department’s partnership with a non-profit advising group; and
- Encouraging community colleges as rescue schools for ITT students.

In short, the Department is to be commended for tackling the problems at ITT head-on, and for heeding critiques and learning from the Corinthian sale.

New Lessons to be Learned from ITT’s Demise

Today, there are new lessons to learn from the Department’s handling of ITT, including the need for the Department to:

- Secure larger letters of credit earlier when a school presents obvious financial instability and/or business practices that are likely to cost the Department (and taxpayers) when the school fails;
- Combat consumer fraud earlier when it arises, instead of letting it fester for years at a troubled institution, and utilize all the Department’s existing authority to stop illegal behavior;
- Build bridges now to community colleges and to strengthen vocational and technical education options; and
- Better equip students with information about consumer fraud by college companies.

As the *New York Times* Editorial Board wrote, although the Department was to be commended for taking action against ITT, it should have acted earlier, given the mounting evidence of wrongdoing by ITT.ⁱⁱ

Other College Companies Present Immediate Threats

It is important to study ITT’s failure because there are other education companies that are similarly financially unstable and/or rely on unsustainable business models. Indeed, several other major for-profit college chains are extremely financially unstable, posing a **serious imminent risk to the taxpayer investment** that artificially props them up, and many more have unsustainable business models: Like Corinthian Colleges and ITT, they could not compete in the education market on their own because they would not be able to attract students to their over-priced, subpar education. They charge tuition that is too

high for the “market” to bear, especially given the low educational quality, and they fail to invest in education, instead reducing education spending in order to set aside larger sums for profit and executive compensation. These business decisions guarantee they will eventually lose students. Such business models are unsustainable without taxpayers’ propping them up.

In addition, many of these companies depend on deceiving and coercing students in order to convince them to enroll in the high-priced, low-quality programs. Such schemes will eventually cost millions of dollars in “Borrower Defense” discharges and the Department should act now to secure school letters of credit to cover these costs. In addition, these illegal schemes will increasingly run afoul of stronger regulations and law enforcement efforts. The evidence of wrongdoing is mounting at these schools, and the Department of Education should take action now to protect students and taxpayer dollars.

What is Needed Now

The U.S. Education Department must take immediate action to analyze the risk to taxpayers and students at college companies that are widely viewed – by Wall Street and industry analysts, as well as by education experts – as being severely financially unstable and using an unsustainable business model. The Department must act when there are schools that are at imminent risk of costing taxpayers billions of dollars in closed school discharges and borrower defense (fraud) discharges. The Department has an obligation to protect taxpayer dollars and students by taking steps now to:

- (1) Secure letters of credit that are large enough to cover the potential future cost of **closed school discharges** at schools that are financially unstable;
- (2) Secure letters of credit that are large enough to cover the potential future cost of **borrower defense discharges** at schools where there is evidence both of consumer fraud and of student complaints (suggesting students are likely to file for their right to borrower defense, which would pose a drain on the Treasury absent sufficient letters of credit);
- (3) Immediately put on **reimbursable status** the schools that are at imminent risk of financial demise, so that Title IV funds are not lost when the schools inevitably collapse.

Similarly, the U.S. Department of Veterans Affairs (VA) has an obligation to protect veterans and taxpayer dollars by:

- (1) Investigating schools where students are complaining of illegal practices, as well as schools at which federal or state law enforcement have identified sufficient evidence of consumer fraud to launch investigations;
- (2) Complying with federal law (38 U.S.C. 3696) by disapproving GI Bill at schools that have engaged in deceptive recruiting. VA’s failure to abide by this statutory requirement has been documented by Yale Law Schoolⁱⁱⁱ and caused a letter to the VA Secretary from the nation’s largest veterans and military organizations,^{iv} reported on page 4 of the *New York Times*.^v

Voluntary Improvements by Schools: Best Practices

Schools don't need to engage in deceptive and predatory behavior. Instead, they can prioritize veterans by offering them support and respect on campus. Voluntary improvement in how schools treat veterans can make a significant difference in veterans' educational success.

Most commendably, for example, DeVry announced in September 2016 it would voluntarily close the 90/10 loophole in its business practices by no longer counting GI Bill and Defense Department student aid to offset its cap on federal funds^{vi}; this loophole incentivizes for-profit colleges to treat veterans "as nothing more than dollar signs in uniform," as Holly Petreaus explained.^{vii} DeVry is to be commended for leading the industry in voluntarily ending the aggressive and deceptive targeting of veterans. DeVry also volunteered to lower its reliance on federal funds, an important step towards financial stability. (A separate white paper on voluntary improvements and best practices is also available from Veterans Education Success.)

I. What Led to ITT's Collapse

A. Wall Street Experts Point to ITT's Business Decisions

As the *New York Times* business reporter wrote in the *Times*' post-mortem analysis of ITT, strong returns on Wall Street for the for-profit college industry enabled many to turn a blind eye to the abusive practices underlying those strong returns.

"From 2000 to 2003, the sector outran every other on Wall Street. Publicly traded post-secondary-education shares climbed 460 percent, according to one analysis, compared with a 24 percent loss for the Standard & Poor's 500-stock index. Some mutual fund managers boasted that the schools' owner, ITT, had been their most profitable stock.

Yet even as business was booming, troubling accusations of abusive practices in the industry like the ones that resulted in the 2004 federal raid bubbled up. That investigation, brought initially by the United States attorney's office in Houston, was ultimately closed, but suspicions continued to trail ITT and other for-profit giants."²

Similarly, the *Indianapolis Business Journal*'s post-mortem analysis noted that ITT was more than 90% reliant on federal aid at the time of its demise, while sporting a 70% student loan default rate on its loans. The *Journal* noted that Wall Street analysts

"began waving the red flag about ITT seven years ago, when the company's stock was above \$100 [because of] fundamental concerns: Tuition was too high (about

² http://www.nytimes.com/2016/09/08/business/downfall-of-itt-technical-institutes-was-a-long-time-in-the-making.html?_r=1

\$45,000 for a two-year associate’s degree) and the quality of the educational programs too low—a combination that left many students buried in debt they had no ability to repay.

As pressure to improve intensified in recent years. . . the company responded by propping up short-term results by spending billions of dollars on share buybacks (which lift earnings per share by reducing the number of shares outstanding) and slashing spending on educational programs.

“At its core, in the seven-plus years we recommended selling or shorting the stock, at no point did they take a step that would actually improve educational outcomes for their students,” [one Wall Street advisor] said. He added: “Everything they did was to preserve near-term profitability at the expense of the long-term sustainability of these institutions.”³

The *Indianapolis Business Journal*’s Editorial Board added its voice to the chorus of critics who blamed ITT, not the government for ITT’s demise. The Board explained, quoting Wall Street analyst Trace Urdan:

“[There were] real concerns that the sector’s expensive diplomas too often left students awash in debt while failing to properly prepare them for gainful employment. . . . Then there were the financial blunders—many driven by the board’s penchant for winning favor with investors instead of putting the long-term interests of the schools and their students first. Those included cutting back on capital expenditures and instead burning through cash by buying back more than \$2 billion in stock, mistakenly assuming the company would always have access to debt markets. “The prudence [of buying back stock] in a complex and increasingly hostile regulatory environment was not something investors well understood,” [Wall Street analyst Trace] Urdan said. “This was the purview of the board, and in this respect we believe it objectively failed.”⁴

B. Timeline of Bad Behavior by ITT

In retrospect, the U.S. Department of Education (“ED”) should have acted sooner and with more force against ITT, given the long history of public information and law enforcement concerns about ITT Tech’s questionable business practices, and especially given the significant public attention to illegal behavior at ITT in recent years.

- *September 1998*: ITT settled 8 legal proceedings involving 25 former students and the claims of 15 other former students. ITT recorded a \$12.9 million

³ <http://www.ibj.com/articles/60201-what-did-itt-in-short-sighted-thinking-critic-says>

⁴ <http://www.ibj.com/articles/60392-itt-missteps-sowed-fate>

provision in September 1998 associated with the settlement of these legal proceedings.⁵

- *February 25, 2004*: Federal agents raided the company's headquarters and ten of its campuses in Indiana, Texas, Virginia, Florida, Louisiana, Nevada, California and Oregon for documents and information related to ITT's placement figures and rates, retention figures and rates, graduation figures and rates, attendance figures and rates, recruitment and admissions materials, student grades, graduate salaries and transferability of credits to other institutions.⁶ The investigation negatively affected the company's stock and triggered several class action lawsuits by investors.
- *2004*: California Attorney General investigated ITT in California for falsifying student records to qualify students for CalGrants and for retaliating against employees who complained.
- *July 2004*: ITT's CEO resigned while federal and state investigations of fraud continued.⁷
- *October 17, 2005*: ITT announced it had agreed to pay \$725,000 to settle a lawsuit in which employees charged that ITT had inflated students' grade point averages so they qualified for more financial aid from the State of California.⁸
- *Aug. 4, 2010*: U.S. Senate Committee on Health, Education, Labor & Pensions (HELP) hearing profiled ITT's notorious "Pain Funnel" tool for its recruiters to manipulate prospective students' emotional vulnerability.
- *2010 - 2012*: Senate HELP Chairman Harkin goes to the Senate Floor many times to formally release ITT internal documents and information about ITT's deceptive recruiting and fraudulent PEAKS loan program
- *July 2012*: Senate HELP Committee Report released on ITT's deceptive recruiting tactics and vulnerable financial model.
- *Feb. 2013*: U.S. Securities & Exchange Commission (SEC) Subpoenas ITT Educational Services.

⁵ <https://www.sec.gov/Archives/edgar/data/922475/0000950131-99-000363.txt>

⁶ See Las Vegas Sun, "Agents Raid ITT Tech Schools" (Feb. 25, 2004) available at <http://lasvegassun.com/news/2004/feb/25/agents-raid-itt-tech-schools/>

⁷ <https://business.highbeam.com/5280/article-1G1-120189217/waddles-resigns-itt-president>

⁸ See Doug Lederman, Inside Higher Ed, "ITT, Calif. Settle False Claims Lawsuit." (Oct. 18, 2005), available at <https://www.insidehighered.com/news/2005/10/18/itt>

- *Jan 2014:* 12 state Attorneys General send Civil Investigative Demand (investigation) to ITT (6 more Attorneys General join in Feb, April and May)
- *Feb 2014:* Lawsuit by U.S. Consumer Financial Protection Bureau (CFPB) for an illegal loan scheme in which ITT signed students up for high-interest loans without their permission;
- *Feb. 2014:* Lawsuit by New Mexico Attorney General for lying to students about the accreditation of its nursing degree, leaving them unable to work as nurses;
- *March 2014:* NY Stock Exchange notifies ITT that it will be delisted for not filing a 2013 annual report (it later grants ITT an extension);
- *Early August 2014:* ITT CEO resigns suddenly; many financial analysts stop following ITT
- *Late August 2014:* ED puts ITT on Heightened Cash Monitoring and demands a Letter of Credit from ITT for \$80m for not filing 2013 financials as required
- *2014-2016:* Hundreds of ITT student veterans complained to the Department of Veterans Affairs (“VA”) about deceptive recruiting through VA’s online student feedback portal.
- *May 12, 2015:* SEC announces fraud charges against ITT Educational Services Inc., its chief executive officer Kevin Modany, and its chief financial officer Daniel Fitzpatrick “for fraudulently conceal[ing] from ITT’s investors the poor performance and looming financial impact of two student loan programs that ITT financially guaranteed.”⁹
- *October 2015:* ED, VA, and the U.S. Department of Justice (“DOJ”) are alerted that a ITT Campus President turned Whistleblower has come forward, alleging a serious "GI Bill scam" as well as evidence of defrauding the federal government.
- *January 2016:* Unsealing of False Claims Act lawsuit by ITT Dean of Admissions, alleging ITT routinely misled prospective students about the programs offered and the training provided, enrolled students who could not benefit from the programs, and that financial aid officers routinely encouraged students to lie on FAFSA.
- *Early 2016:* DOJ & ED interview ITT Campus President whistleblower.
- *March 2016:* Lawsuit by Massachusetts Attorney General for deceptive recruiting,

⁹ <https://www.sec.gov/news/pressrelease/2015-86.html>

- *April 2016:* ITT is put on "show cause" order by its accreditor, ACICS.
- *June 6, 2016:* ED raised ITT's Letter of Credit from \$80 million to \$124 million (10% to 20% surety) due to increased risk
- *June 23, 2016:* ED's National Advisory Committee on Institutional Quality and Integrity (NACIQI) votes to recommend the accreditor ACICS be revoked
- *July 2016:* ED agrees to allow ITT to provide increased surety in three installments of +\$14 million.
- *July 20, 2016:* ITT makes first of three installments of \$14,646,000. Next 2 installments set for Sept. 30 and Nov. 30.
- *August 4, 2016:* ACICS holds hearing on ITT
- *August 17, 2016:* ACICS continues "show cause" order for ITT
- *August 25, 2016:* ED announces surety for ITT increase an additional \$153 million within 30 days, HCM2, no new Title IV, and executive compensation limitations
- *September 6, 2016:* ITT closes all campuses, effective immediately.
- *September 16, 2016:* ITT Educational Services files for bankruptcy protection

C. ITT Was Financially Unstable for a Long Period of Time

In 2015, ESI reported almost \$850 million in total revenue, of which roughly \$580 million was sourced from federal aid dollars. In 2015, approximately 45,000 students were enrolled in ITT programs.

However, ITT Educational Services was on shaky ground for years, though much of it was hidden from shareholders and the public. In the quarter preceding its closing, ESI even reported a net profit. But its underlying shaky finances were apparent to those looking more closely at their balance sheet and financial reports.

One indicator of ITT's problems was the company's stock price, which began losing value in 2007 and experienced years of volatility afterward. What appeared as dramatic and sudden losses in stock price were the results of years of waste, fraud, and abuse.



Source: Yahoo Finance

Since 1973, ITT Educational Services had become increasingly dependent on federal funding, including Pell Grants and federal student loans. Deregulation in 1998 also gave ITT Tech an opening to more federal funds.

In 2012, about 80% of ITT Tech’s funds came from federal sources. In the months before its collapse, according to its final 10Q filing with the SEC, approximately 95% of the company’s revenues came from government sources: Pell Grants, federally-backed loans, GI Bill benefits, U.S. Defense Department (DOD) student aid, and state funds.

It also appears that the company developed a *culture of silence*: intimidating those who criticized the company or revealed potentially damaging information.

In addition, the Office of the Attorney General for the State of California (“CAG”) is investigating our ITT Technical Institutes in California. We believe that the CAG’s investigation is in response to one or more qui tam actions filed against us under the state and/or federal False Claims Acts. The CAG has not asserted any claims against us, and we have not been informed of the specific matters that the CAG is investigating. Based on the information that the CAG has requested, however, we believe that the CAG is investigating, among other matters, whether one or more of our California ITT Technical Institutes:

- falsified records relating to student attendance, grades and academic progress;
- falsified student grade point average calculations used to qualify students for financial aid under the State’s Cal Grant Program; and
- retaliated against employees who may have complained about those alleged acts.

Source: SEC (2004)

ITT spent a great deal on executives rather than reinvestment. From October 2006 to October 2007, CEO Rene Champagne cashed out more than \$65 million in ITT shares.

| | | | | | |
|------------|-------------------------------------|-----------|---------|--------|------------|
| 2007-10-02 | Champagne Rene R (Director) | Sale | 31,900 | 120.01 | 3,828,570 |
| 2007-10-02 | Champagne Rene R (Director) | Option Ex | 31,900 | 23.70 | 756,030 |
| 2007-10-01 | Champagne Rene R (Director) | Sale | 103,100 | 120.24 | 12,466,599 |
| 2007-10-01 | Champagne Rene R (Director) | Option Ex | 103,100 | 23.70 | 2,443,470 |
| 2007-06-26 | Champagne Rene R (Director) | Sale | 57,500 | 111.95 | 6,439,391 |
| 2007-06-26 | Champagne Rene R (Director) | Option Ex | 57,500 | 17.25 | 991,875 |
| 2007-06-19 | Champagne Rene R (Director) | Sale | 57,500 | 113.17 | 6,511,732 |
| 2007-06-19 | Champagne Rene R (Director) | Option Ex | 57,500 | 17.16 | 986,412 |
| 2007-06-12 | Champagne Rene R (Director) | Sale | 57,500 | 116.68 | 6,703,014 |
| 2007-06-12 | Champagne Rene R (Director) | Option Ex | 57,500 | 17.06 | 980,949 |
| 2007-06-05 | Champagne Rene R (Director) | Sale | 57,500 | 114.35 | 6,580,385 |
| 2007-06-05 | Champagne Rene R (Director) | Option Ex | 57,500 | 17.06 | 980,949 |
| 2007-02-02 | Champagne Rene R (Chairman and CEO) | Sale | 242,200 | 80.00 | 19,376,000 |
| 2007-02-02 | Champagne Rene R (Chairman and CEO) | Option Ex | 242,200 | 10.28 | 2,490,058 |
| 2007-01-09 | Champagne Rene R (Chairman and CEO) | Sale | 26,800 | 68.64 | 1,839,562 |
| 2007-01-09 | Champagne Rene R (Chairman and CEO) | Option Ex | 26,800 | 10.84 | 290,619 |

| | | | | | |
|------------|---|-----------|--------|-------|-----------|
| 2006-10-16 | Champagne Rene R (Chairman and CEO) | Sale | 29,065 | 70.40 | 2,046,228 |
| 2006-10-16 | Champagne Rene R (Chairman and CEO) | Option Ex | 29,065 | 6.75 | 196,188 |

Source: Insider Monitor

In the later 2000s, ITT Tech continued to grow the number of campuses to 141 sites, even as its financial condition worsened.

Instead of investing in education when it needed to, ITT Tech resorted to more deceptive marketing and cutting financial corners. ITT infamously created the “Pain Funnel and Pain Puzzle” to assist its recruiters in digging for prospective students’ pain and emotionally manipulating them to enroll. During an August 2010 Senate hearing, the pain funnel was discussed, and the company admitted it had been proposed for an internal company award.

When fines were finally incurred or funding was restricted due to poor management and unethical behavior, the company was unable to sustain itself financially, and it resorted to desperate measures, borrowing large amounts of money.

As the stock started dropping in 2007, public retirement funds such as CALPERS and other passive retirement funds lost money as shareholders in ESI.

Prominent individual and institutional shareholders such as Richard C. Blum and Blum Capital Partners abandoned ITT’s parent investment company, ESI, in 2013, three years before its final collapse.

The company’s unraveling finances became increasingly obvious when the company borrowed \$79 million from JP Morgan and \$100 million from Cerebus in 2014. In late 2014, with no explanation, Pricewaterhouse Coopers (PwC) also left its \$6 million dollar auditing deal with ITT.

D. ITT’s Business Model Was Unsustainable

In addition to shaky finances, ITT’s very business model was unsustainable. It could not compete in the market by itself because it could not attract students to its over-priced, subpar education. It could entice students only by employing consumer fraud. In short, ITT existed only because it was propped by the Education Department; its business model was unsustainable without taxpayers’ propping it up. For example, ITT:

- **Relied Heavily on “Churn”:** ITT’s practice of enrolling students, letting them drop out, and then enrolling more to take their place, is known in the industry as student “churn.” ITT also engaged in heavily illegal practices to entice students

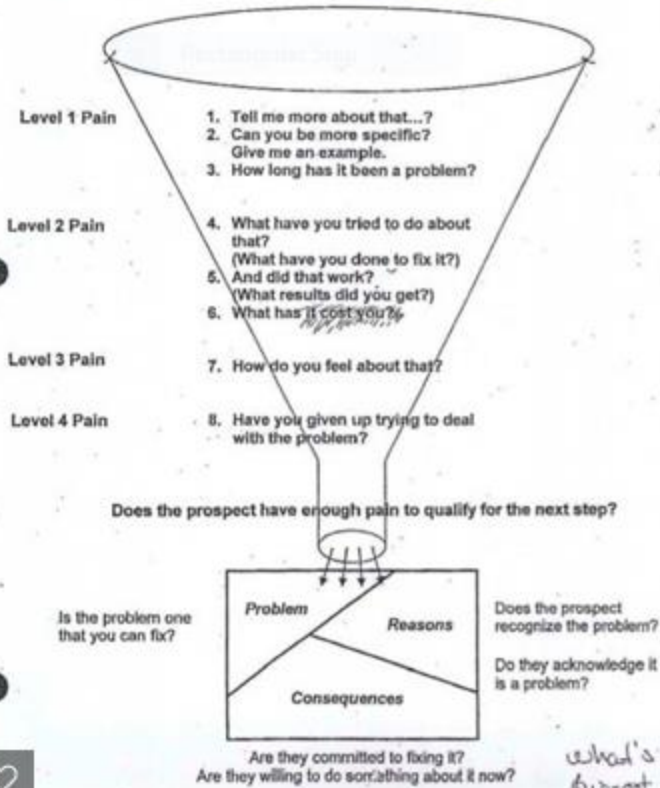
to enroll. As an ITT campus president-turned-whistleblower explained to the Education Department in 2015, although the company had cleaned up its recruiters' printed materials, everything that was not printed remained deceptive and fraudulent. The very culture was to encourage its recruiters to "do anything and say anything" behind closed doors.

- **Priced its Tuition Too High:** ITT Tech tuition was approximately \$45,000 for an Associates' degree. Comparable community colleges charged a small fraction of the price. By charging tuition that was too high for the "market" to bear, ITT guaranteed it would eventually lose all its students.
- **Reduced Educational Quality to Cut Expenses:** Students complained for years that ITT's educational offerings were subpar, with materials outdated by years. Campuses did not upgrade software or hardware necessary for up-to-date technical education. Approximately 90% of ITT's instructors were part-time instructors. Two documented investigations involved grade inflation.
- **Engaged in Predatory Recruiting Measures:** Recruiters engaged in predatory recruiting measures, including manipulation and deception (e.g., using its infamous "pain funnel" to locate sources of vulnerability). ITT also misled students about its accreditation, the subject of the New Mexico Attorney General's February 2014 lawsuit against ITT for its improperly accredited Nursing Degree which left graduates ineligible to even sit for the nursing licensing exam. In early 2008, ITT Tech reported that they employed "approximately 1,100 full- and part-time recruiting representatives to assist in local recruiting efforts." ITT also hired predatory lead generation websites to find prospective students.



2. Pain Funnel and Pain Puzzle

Eight Questions



(Source: U.S. Senate HELP Committee)

- **Objected to Consumer Information:** ITT Tech was a member of APSCU, an industry lobbying group designed to reduce oversight, fight consumer awareness, and block consumer protection measures.
- **Pushed Private Loans to Fill Gaps in Student Funding and Launched a Usury, Illegal Loan Scheme:** Rather than recognizing that its tuition was too high, ITT Tech came up with private loan schemes (PEAKS, CUSO) to fill in gaps in student funding, signing students up for loans (sometimes without their knowledge or authorization) at exorbitant interest rates. These loans had enormous default rates. The CUSO loans also damaged participating credit unions.
- **Deceived Shareholders and Utilized Questionable Accounting Procedures:** ITT's PEAKS loan program – exposed by the Senate Committee in 2010 and the subject of CFPB's lawsuit in February 2014 – was another troubling aspect of its unsustainable business model.

As the SEC found in its May 2015 lawsuit against ITT, CEO Kevin Modany, and CFO Daniel Fitzpatrick, ITT and the two executives fraudulently concealed from ITT's investors the poor performance and looming financial impact of two student loan programs that ITT financially guaranteed. ITT formed both of these student loan programs, known as the "PEAKS" and "CUSO" programs, to provide off-balance sheet loans for ITT's students following the collapse of the private student loan market.

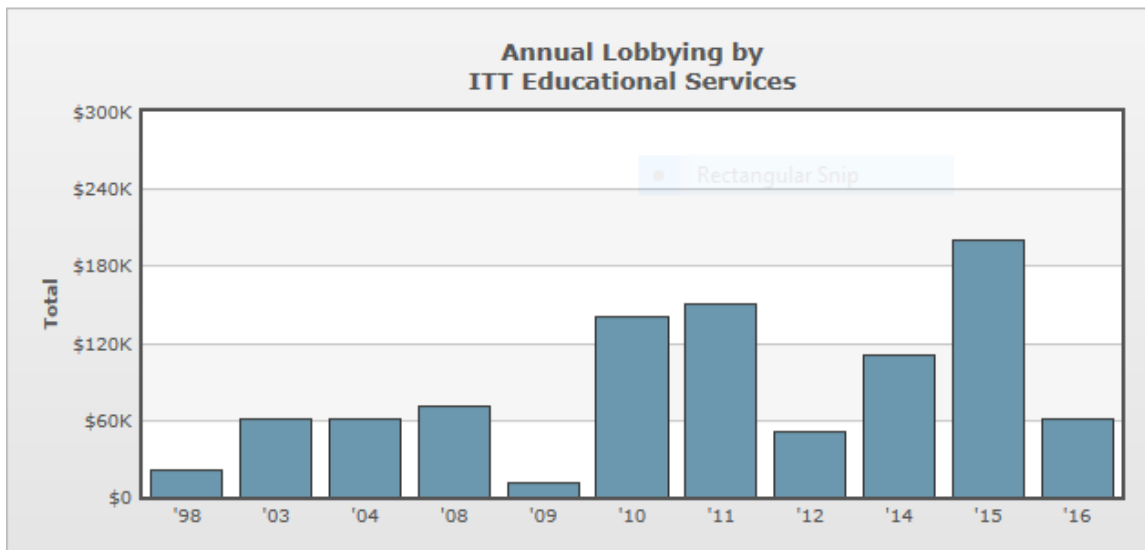
To induce others to finance these risky loans, ITT provided a guarantee that limited any risk of loss from the student loan pools. According to the SEC, the underlying loan pools had performed so abysmally by 2012 that ITT's guarantee obligations were triggered and began to balloon. Rather than disclosing to its investors that it projected paying hundreds of millions of dollars on its guarantees, ITT and its management took a variety of actions to create the appearance that ITT's exposure to these programs was much more limited.

Over the course of 2014, as ITT began to disclose the consequences of its practices and the magnitude of payments that ITT would need to make on the guarantees, ITT's stock price declined dramatically, falling by approximately two-thirds. "Our complaint alleges that ITT's senior-most executives made numerous material misstatements and omissions in its disclosures to cover up the subpar performance of student loans programs that ITT created and guaranteed," said Andrew J. Ceresney, Director of the SEC's Division of Enforcement. "Modany and Fitzpatrick should have been responsible stewards for investors but instead, according to our complaint, they engineered a campaign of deception and half-truths that left ITT's auditors and investors in the dark concerning the company's mushrooming obligations."

The SEC's complaint alleges that ITT, Modany, and Fitzpatrick engaged in a fraudulent scheme and made a number of false and misleading statements to hide the magnitude of ITT's guarantee obligations for the PEAKS and CUSO programs. For example, ITT regularly made payments on delinquent student borrower accounts to temporarily keep PEAKS loans from defaulting and triggering tens of millions of dollars of guarantee payments, without disclosing this practice. ITT also netted its anticipated guarantee payments against recoveries it projected for many years later, without disclosing this approach or its near-term cash impact. ITT further failed to consolidate the PEAKS program in ITT's financial statements despite ITT's control over the economic performance of the program. ITT and the executives also misled and withheld significant information from ITT's auditor.

- **Re-Directed Billions of Dollars of Student Funding to Stock Buy-Back:** Rather than investing in education, ITT bought back more than \$2 billion in stock in 1997, which inflated the stock price.

- **Blocked Transparency and Accountability:** Forced arbitration clauses and gag rules maintained a *culture of silence* that reduced transparency and accountability. We cannot know how many dissatisfied students were unable to sue because of arbitration clause, or who settled their claims, but were unable to speak about their agreements.
- **Heavy Spending on Lobbyists Instead of Educational Quality:** Rather than invest in students, ITT invested in lobbyists to keep the flow of federal funds artificially propping up the failing school. It also invested in campaign contributions to lawmakers it hoped could maintain its spigot of federal funds.



Source: Open Secrets

Top Recipients

| | Recipient | Total | From Indivs | From Orgs |
|-------|------------------------|----------|-------------|-----------|
| CANDS | Romney, Mitt | \$22,300 | \$22,300 | \$0 |
| CANDS | Kline, John | \$9,255 | \$9,255 | \$0 |
| CANDS | Boehner, John | \$8,000 | \$8,000 | \$0 |
| LEAD | Freedom & Security PAC | \$6,850 | \$6,850 | \$0 |
| CANDS | Andrews, Robert E | \$3,500 | \$3,500 | \$0 |
| CANDS | Rokita, Todd | \$3,250 | \$3,250 | \$0 |
| CANDS | Mourdock, Richard E | \$2,850 | \$2,850 | \$0 |
| CANDS | Foxx, Virginia | \$2,000 | \$2,000 | \$0 |
| CANDS | Kyrillos, Joe | \$1,000 | \$1,000 | \$0 |

Source: Open Secrets (2012 data)

ITT was one of the most aggressive practitioners of this business model—a model that wasted taxpayer dollars, hurt long-term investors, mired students in federal and private loan debt, and left students without a degree or unable to find a job in their career field.

It is important to recognize these are business decisions and represent an unsustainable business model. Rather than investing in education, ITT poured its money into stock buy-backs and excessive CEO salaries.^{viii}

Senate Findings in 2012

The following table compares the business model of the 30 for-profit schools studied by the Senate HELP Committee in its 2010-2012 investigation and 2012 final report, to that of ITT, which was one of the schools examined.

For-Profit Schools' Business Model, per 2012 US Senate Committee Investigation:

| Business model | 30 for-profit schools studied | ITT |
|----------------|--|---|
| Tuition | <ul style="list-style-type: none"> most charge higher tuition than comparable programs at community colleges and flagship state universities. BA degrees were 20 percent costlier and Associate degrees and Certificate programs were four to four- and-one half more expensive for-profits regularly raise tuition, and | <ul style="list-style-type: none"> ITT Tech degrees cost approximately \$45,000 for an AA and \$80,000 for a BS. In comparison, Ivy Tech, a community college cost \$9,385 for a similar AA degree. |

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| | <p>some do so to create a gap between tuition and what federal and state aid will cover, forcing students to pay cash or take out private student loans, which help schools to maintain 90/10 compliance</p> <ul style="list-style-type: none"> vast majority of students left with student loan debt that may follow them throughout their lives, and can create a financial burden that is extremely difficult, and sometimes impossible, to escape | <ul style="list-style-type: none"> In 2013, USA Today reported that several ITT Tech schools had student loan default rates higher than graduation rates. The default rate in 2011 was 22%. |
| Federal revenue | <ul style="list-style-type: none"> received an average of 79% of their revenue from federal student aid plus military and veteran educational benefits (86% at the 15 publicly-traded schools) targeted veterans in order to evade the 90/10 rule 8 of the top 10 recipients of veterans Post-9/11 GI bill funds were for-profit education companies | <ul style="list-style-type: none"> In 2010, ITT Tech received 60.8% of funds from Title IV and an additional 5.1% from DOD and the VA. ITT was the second highest recipient of post-9/11 GI Bill funds, taking in \$178 million between 2009 and 2011. |
| Expenditure priorities | <ul style="list-style-type: none"> 15 publicly-traded schools spent 23% of revenue on marketing and recruiting (\$3.7 billion) and dedicated 19.7% to profit (\$3.2 billion) in 2009 | <ul style="list-style-type: none"> In 2009, ITT allocated 19.1% of revenue (\$252 million) to marketing and recruiting. |
| Executive compensation | <ul style="list-style-type: none"> CEOs at 15 publicly-traded schools took home an average of \$7.3 million in 2009, significantly outpacing compensation of community college and public school presidents | <ul style="list-style-type: none"> In 2009, ITT CEO Kevin Modany received \$7.6 million in compensation, more than 22 times as much as the president of Indiana University at Bloomington. |
| Recruiting tactics | <ul style="list-style-type: none"> Recruit as many students as possible because enrollment growth is critical to their business success, particularly for publicly traded companies whose revenue and profit expectations are closely watched by Wall Street Employed 35,202 recruiters, or about 1 recruiter for every 53 students attending in 2010, but relatively few career and student services staff per student Recruiters trained to call prospective students multiple times a day, to | <ul style="list-style-type: none"> ITT Tech used a manipulative systematic process of recruitment called “the pain funnel.” In 2010, ITT Tech had 2,550 recruiters. Recruiters were instructed to make 140 calls per day if they had no appointments, and 100 calls per day if they had an appointment. Recruiters were trained to mislead |

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| | <p>create a sense of urgency to enroll, and to identify and exploit vulnerabilities and pain in their lives in order to persuade them to enroll</p> <ul style="list-style-type: none"> • Internal documents, interviews with former employees, and Government Accountability Office (GAO) undercover recordings demonstrated that many companies used tactics that misled prospective students with regard to the cost of the program, the availability and obligations of federal aid, the time to complete the program, the completion rates of other students, the job placement rate of other students, the transferability of the credit, or the reputation and accreditation of the school | <p>prospective students about the cost of attending the school.</p> <ul style="list-style-type: none"> • ITT had a “military marketing plan” to increasing military enrollments. • Pressure to recruit students resulted in the use of some misleading and deceptive tactics. • Students were not told that their credits would not transfer, and many were lied to about the transferability of ITT credits. |
| <p>Academic quality/student outcomes</p> | <ul style="list-style-type: none"> • 80% of faculty on average were part-time with higher percentages at some schools, raising questions about their ability to exercise academic independence to balance the company’s business interests • 15 publicly traded schools spent between \$892 and \$3,962 per student annually on instruction, significantly less than public and non-profit schools but comparable to community colleges which have significantly lower tuition • overall, devoted less to actual instruction costs (faculty and curriculum) than to either marketing and recruiting or profit • 54% of students who enrolled in 2008-09 had withdrawn by 2010 and 9 companies had Associate degree programs with withdrawal rates over 60 percent • 64% of students attending online programs left without a degree compared to 46 percent of students attending campus-based programs offered by the same companies • among the 15 publicly traded | <ul style="list-style-type: none"> • In 2010, ITT Tech employed 1,682 full-time instructors and 4,473 part-time faculty (27% full-time). • In 2009, ITT spent \$2,839 per student on instruction, compared to \$3,156 per student on marketing and \$6,127 per student on profit. • In 2010, ITT Tech’s withdrawal rate was 52% • Only 5% of students completed their degrees between 2008 and 2009. • ITT Tech’s student loan default rate was 26.3% in 2008, but was projected to increase significantly. • CUSO (credit union) and PEAKS loans programs both failed. CUSO loans hurt credit unions involved in the program after many students defaulted. • Default rate on private loans was |

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| | <p>companies, 55% of students departed without a degree compared to 46% of students among the 15 privately held companies examined</p> <ul style="list-style-type: none"> • student loan default rates increased across all 30 companies examined between 2005 (17.5%) and 2008 (22.6%), a 32.6% increase over 4 years and many schools devoted, significant resources to lowering their measured default rates by persuading students at risk of default to enter forbearance or deferment | <p>estimated to be 64%.</p> |
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Sources: 2012 Senate HELP Committee Report, USA Today, Credit Union Times

Note: Unless otherwise noted, statistics cited apply to all 30 for-profit schools examined by the Senate Committee.

II. Unsustainable Business Model Caused Accreditation Problems for ITT

ITT Tech was nationally accredited by the *Accrediting Council for Independent Colleges and Schools (ACICS)*, not regionally accredited. (Regional accreditation is usually necessary for credits to transfer to quality schools.)

In August 2016, ITT’s accreditor, the Accrediting Council for Independent Colleges and Schools (ACICS) determined that ITT “is not in compliance, *and is unlikely to become* in compliance with [ACICS] Accreditation Criteria” (emphasis added). This came amid increasingly heightened financial oversight measures put in place by the Department over the past two years due to significant concerns about ITT’s administrative capacity, organizational integrity, financial viability, and ability to serve students. The August 17, 2016, “Continue Show-Cause Directive Letter” from ACICS continued to question ITT’s compliance with a number of the agency’s accreditation standards, finding that ITT had not demonstrated full compliance. The standards in question are:

- “Minimal eligibility requirements” for “compliance with all applicable laws and regulations;”
- Federal and state student financial aid administration requirements;
- Financial stability, including having adequate revenues and assets to meet its responsibilities;
- Administrative capacity, including overall management and record-keeping;
- ACICS admissions and recruitment standards;
- Requirements for student achievement, as measured by retention, placement, and licensure passage rate; and
- Institutional integrity, as manifest in the efficiency and effectiveness of its overall administration of the institution.

On September 22, 2016, the US Department of Education publicly announced that ACICS had been relieved of its accreditation power.

ACICS lost its status with ED because it, among other factors:

- failed to confirm the validity of schools' reported statistics on student performance;
- failed to sanction undeserving institutions; and
- failed to identify conflicts of interest among board members, many of whom worked at schools under investigation.

ACICS' loss of power, like ITT Tech's demise, was self-inflicted. According to a report by the Center for American Progress' Ben Miller, from 2010 to 2015, there were 90 instances where ACICS named campuses or institutions to its honor roll around the same time they were under investigation by state or federal government agents for consumer fraud and other illegalities. For example, ACICS failed to raise any public alarm bells about South Florida's notorious FastTrain College. ACICS named FastTrain to its honor roll in 2011 for its "excellent understanding" of the quality assurance process. The college used exotic dancers to recruit students and was raided by the FBI in 2012 after taking in federal aid for individuals who did not have high school diplomas. The college is now closed, and its CEO was convicted of criminal fraud and sent to prison in 2015.

III. The Education Department's Action

A. Terms of the U.S. Education Department's Order to ITT Tech

On August 25, 2016, noting that ITT's accreditor had determined that ITT was "*unlikely to become* in compliance" with minimal accreditation standards, the Education Department [outlined in a letter](#) to ITT Educational Services, the following restrictions:

- **Enrollment restrictions:** ITT could no longer enroll new students who rely on federal financial aid dollars for educational expenses;
- **Disclosures to Students:** ED required ITT to inform current students that its accreditor had found that the institution was not in compliance and was unlikely to become in compliance with its Accreditation Criteria;
- **Compensation and Payment Limitations:** ITT was prohibited from awarding raises, paying bonuses or making retention or severance payments to its executives or to paying special dividends or out of the ordinary expenditures without department approval;
- **Notification of Financial Events requirements:** ITT would have had to inform the Department of any significant financial or oversight events including violations of existing loan agreements or extraordinary financial losses within ten days of such events; and

- **Heightened Cash Monitoring:** ITT was required to use its own funds to initially cover Title IV aid disbursements for current students. The Department would reimburse funds to ITT *after* aid is disbursed to students.

Additionally, within 30 days, ITT was required to increase its existing surety from \$94,353,980 to \$247, 292,364, or 40 percent of all Title IV aid the school received in 2015 payable in full. (Surety funds are held by the Department in a Federal Holding Account and are used to reimburse the Department for liabilities related to the investigations, including student refunds, student loan cancellations and other expenses if ITT closes campuses.)

Finally, ITT was required to develop teach-out agreements with other colleges that provide students with opportunities to complete their studies. (Teach-out agreements are developed in the event an institution, or an institutional location, ceases operations before all enrolled students have completed their program of study.)

U.S. Education Secretary John King explained the Department’s actions:

“Our responsibility is first and foremost to protect students and taxpayers. Looking at all of the risk factors, it’s clear that we need increased financial protection and that it simply would not be responsible or in the best interest of students to allow ITT Tech to continue enrolling new students who rely on federal student aid funds.”

“When we allow institutions to participate in federal student aid programs, they are obligated to responsibly manage those funds,” said [U.S. Under Secretary of Education Ted Mitchell](#). “More importantly, we trust they will act in good faith and in the best interests of students.”

Since August 2014, ITT had been subject to intense financial and operational oversight by the Department. The school was previously placed in a Provisional Program Participation Agreement (PPPA) due to late submission of annual compliance audits and financial statements and was concurrently required to post a letter of credit in the amount of \$79,707,879 – representing 10% of the Title IV aid funding received during the preceding fiscal year.

In June 2016, the Department required ITT to post an additional \$44 million to its letter of credit bringing the total surety to roughly \$124 million, or 20 percent of Title IV funds received last year. This increase followed an ACICS determination that “call[s] into question the institutions’ administrative capacity, organizational integrity, financial viability and ability to serve students in a manner that complies with ACICS standards.”

B. How the Education Department Learned from Its Handling of Corinthian and Handled ITT Much More Effectively

Education Department officials learned important lessons from the fallout of the Department's problematic sale of Corinthian to ECMC when Corinthian collapsed under the weight of its consumer fraud. Rather than arranging another sub-prime buyer for ITT that might similarly have failed to serve students, and rather than using taxpayer funds to prop up a failed business model, the Department instead left ITT to suffer its own fate for its poor business decisions. The Department cut off federal funds for new Title IV enrollments, while allowing current Title IV students to continue at the school. ITT immediately chose to stop all new enrollments and, within weeks, decided to shut down all its campuses and declare bankruptcy. Without federal funds to artificially prop it up, ITT's poor business model was exposed as unsustainable.

Lessons Learned from Corinthian:

- **Not Too Big to Fail:** What the Education Department got right with ITT was learning from Corinthian that large subprime colleges cannot be considered “too big to fail.” In contrast, Corinthian, or at least its campuses, were treated as “too big to fail.” In the case of ITT, the Department allowed ITT Tech to kill itself through its poor business decisions and unsustainable business model. The Department stopped propping up an overpriced failure factory. This was the right thing to do and displayed proper stewardship of federal taxpayer funds. Federal taxpayers cannot be expected to serve as a trough for failure factories to enrich themselves off of.
- **Not Tying Students to Another Failure Factory:** Not allowing a sale of ITT also protected ITT students from another failure factory. In contrast, Corinthian was allowed to be sold to a debt collector with no education experience, ECMC, which:
 - Retained many of the Corinthian management. Zenith hired Corinthian's senior VP/Academic officer to fill the same role for the 53 campuses it had purchased, and a number of other Corinthian staff to replicate their roles at Zenith. ECMC stated that it was in the process of recruiting new talent, but ended up hiring questionable executives with a history of fraud, sending the wrong message—a message of continuity rather than reform.
 - Pretended to be nonprofit. Although ECMC registered as a nonprofit, the trend of for-profit colleges reinventing themselves as nonprofit is a troubling sector trend. ECMC's IRS filings suggest that its goal was to gain the legal benefits of nonprofit status while allowing the founders to reap enormous, and inappropriate, financial benefits.^{ix}
 - Insisted that students be banned from joining class-action lawsuits or trying disputes with the school before a jury (although it did agree, under pressure, to end Corinthian's use of mandatory arbitration clauses in its enrollment agreements). Class-action lawsuits are often the only effective

means students can use to obtain legal representation and press schools to abandon bad practices.

- Maintained many of the practices that caused Corinthian Colleges to fold, including keeping the anti-student arbitration clauses, disallowing collective legal actions
 - Suffered a continuation of similar student complaints about the school and its business practices, as consumer websites such as Grad Reports and Consumer Affairs showed in 2016.
- **No Financial Conflict of Interest:** A problem with the Corinthian deal was that the Education Department stood to benefit financially. Under the terms of the sale, ED would receive \$17.5 million from ECMC over the course of 7 years, giving the Department an equity position in the venture. As a result, ED had a strong interest in seeing the company make a healthy profit. Such an arrangement represents a conflict of interest for a federal agency tasked with overseeing ECMC's conduct.
 - **Putting Students First:** Cutting off all new enrollments at ITT, which the Department had not done with Corinthian, protected new students from abuse. The Department also learned to put students first by taking a proactive approach to allowing students to seek "Closed School Discharges." The Department clearly and boldly explained to ITT students their right to have their loans discharged, and the Department sought to make the process as simple and quick as possible for ITT students. This was in sharp contrast to the Department's handling of Corinthian, when ED had acted at times as if it were hiding students' rights to a "Closed School Discharge," even failing to inform Corinthian students of this right at public sessions. Advocates sharply criticized the Department for this and the Massachusetts Attorney General joined Senator Elizabeth Warren in urging ED to forgive federal student loans.^x In addition, the Department had allowed Corinthian to forgive 40% of the principal for Corinthian's predatory private loans while not offering similar federal student loan debt relief. Corinthian's business model of high tuition requiring maximum student loans coupled with poor academic quality left many students with mountains of debt and limited prospects of finding well-paying jobs to help retire that debt. If, rather than facilitating its sale, ED had allowed Corinthian to close its doors, relief from federal student loan debt would have been automatic. Many students were harmed by ED's decision to approve the sale.

VA also handled ITT's closure better than it had handled Corinthian's: VA immediately informed ITT students of their rights, including their right to a "Closed School Discharge" of federal loans, and urged veterans to contact the non-profit organizations Veterans Education Success and Student Veterans of America for assistance.

- **Partnering with Non-Profits to Provide Free Financial & Academic Counseling:** On September 19, 2016, soon after ITT's collapse, the Department

partnered with a non-profit organization that encourages low-income students to finish college, Beyond 12, and the National Association of Student Financial Aid Administrators (NASFAA) to provide free financial and academic counseling, through an online portal, to ITT students and other students affected by college closures. The resources, available at NextStepsEdu.org, match students with experienced financial aid and academic counselors throughout the country who can provide critical guidance as they determine how best to continue their studies. Next Steps EDU advisors respond to questions from students, by email, phone and text message, about academic, financial aid, and federal loan discharge options. All advisors are professionals working in the field of education and will be pre-screened and trained before being matched with students.

- **Encouraging Students to Find Community Colleges as “Rescue Schools”:**

The Department encouraged students to move to community colleges as the best alternative. The Department correctly recognized that community colleges represent the best option as “rescue schools” for ITT students because community college offer similar degrees and certificates, but – unlike some of the for-profit programs – are properly accredited, respected on the job market, and, perhaps most important, are low-cost, such that students need not incur debt to finish their programs. This is particularly important for GI Bill students whose GI Bill months of eligibility may have run out or be nearly out. Public-sector institutions, such as community colleges and state universities, are often better quality, and almost always less expensive alternatives to for-profit schools. And, in the past 20 years, they have begun to embrace online education, a major selling point of for-profit institutions, which had carved out a niche in online education. (A 2015 white paper, on [Lessons Learned from Corinthian’s Demise](#), outlines excellent online college options.) Some advantages of public colleges:

 - **Lower Student Debt:** Although both for-profits and community colleges tend to have high student withdrawal rates, the significantly lower tuition at the latter does not burden students who ultimately withdraw with massive student loan debt. For example, only 13% of students borrow at community colleges compared to 96% at for-profit schools. In addition, public colleges do not actively engage in a business model of “churn” to get student “starts” and federal dollars flowing, the way for-profit colleges do, as documented by the U.S. Senate report.
 - **Lower Tuition:** According to the Senate HELP Committee, Associate and Certificate programs at for-profit schools were four to four and one-half times more expensive than at community colleges and public universities, and 20% more expensive for Bachelor’s degrees than at flagship public universities.
 - **Taxpayer Savings:** Taxpayer savings are greater because students are less dependent on federal student aid. The lower tuitions at public schools result in less borrowing by students, and, lesser investment by taxpayers through Pell Grants. Public school alternatives also save taxpayer dollars for programs like the GI Bill because it covers in-state tuition, which

averages about \$8,000 at public institutions, but pays up to \$20,000 a year for veterans to attend for-profit colleges.

- **Properly Accredited:** Unlike for-profit schools, public-sector institutions are more likely to carry the proper programmatic accreditation and are also more transparent about accreditation and unlikely to mislead students about their ability to obtain the state licenses necessary to turn their degrees into jobs.
- **Honest Recruiting:** Historically, public colleges have tended not to engage in the “boiler room” call centers where recruiters use pain-based, aggressive, and deceptive recruiting tactics, the way for-profit colleges have been documented to do by the U.S. Senate, undercover U.S. Government Accountability Office (GAO) reports, and by multiple federal and state law enforcement actions.
- **Revenues Spent on Education Not Profit & Recruiting:** Public colleges do not face Wall Street pressure to divert funds away from education.
 - Public colleges generally spend a higher amount than do for-profit colleges on instruction, and spend a far lesser amount on marketing and recruiting. For example, Northern Virginia Community College spends about \$4,068 per student per year on instruction and only two-fifths of 1% of its budget to marketing, or about \$22 per student per year. Similarly, Portland Community College in Oregon spends \$5,953 per student per year on instruction, and only about 1.2 percent of its budget, or \$185 per student per year, on marketing. Contrast that with for-profit colleges that spend more on marketing per student per year (averaging \$2,622) than they spend on instruction (\$2,050).
 - Public colleges, by definition, do not set aside any revenue for profit, while for-profit colleges set aside almost 20% of revenue for profit.
 - Public colleges also do not divert revenue to lobbying. In 2010, the for-profit industry spent more than \$8.1 million lobbying Congress.
 - Finally, public colleges do not pay their presidents the exorbitant salaries that for-profit institutions pay their CEO’s and other top executives. The Senate HELP Committee found that the CEOs of the publicly traded, for-profit education companies took home, on average, \$7.3 million in 2009. In contrast, the five highest paid leaders of large public universities averaged compensation of \$1 million, while the five highest paid leaders at non-profit colleges and universities averaged less than \$3 million, and the median salary was less than \$400,000.
- **Student Support Services:** Public colleges invest in student support services that help students succeed in school and beyond, while for-profit colleges have no career placement staff at all, or extremely minimal career placement services. For example, the University of Phoenix, with a student population of nearly half a million, had no career placement staff

at all at the time of the HELP report, but 8,000 recruiters promising the students a terrific career. Bridgepoint-owned Ashford University employed one career placement official for a student population of 77,179 students (as of Fall 2010).

- **Academic Quality:** Academic quality tends to be better at public colleges. An undercover investigation by the U.S. GAO uncovered extremely poor academic quality at for-profit colleges, including teachers who accepted photos of celebrities in lieu of essays and teachers who encouraged the students to cheat. Public colleges have better professors, with a higher percentage of faculty having advanced degrees and teaching fulltime. The majority of faculty at for-profit colleges consists of part-time and adjunct faculty, rather than full-time faculty. The Senate HELP report found that 80% of for-profit college faculty are part-time. Part time and adjunct professors are less expensive to employ and frequently are hired on a short-term basis to minimize educational costs. Part-time faculty have been linked to higher student withdrawal rates.

Non-profit organizations – including Veterans Education Success – put together a comprehensive [list](#) and [map](#) identifying community colleges located near each ITT campus, and these organizations conducted outreach to students to alert them to the community college options near them.

C. Further Analysis of Community Colleges as “Rescue Schools”

i. Timing

While the timing of ITT’s shuttering, coming at the beginning of the Fall semester, would have worked well for a smooth transfer to community colleges (especially for GI Bill students, who might seek an immediate transfer in order not to suffer a break in their housing allowance), this timing may not always be the case. In order to properly serve as rescue schools for students at suddenly shuttered for-profits, community colleges may need to adjust their timing or allow rolling, mid-semester entry of new students, at least to accommodate students if there is another large for-profit chain closing.

ii. Academic Independence: Public Colleges Objected to Education Department Pressure

When ITT Tech collapsed, the Education Department wisely recognized community colleges as the proper rescue school vehicle, and made overtures on behalf of the ITT students to community colleges and community and public college associations. The answer, however, was not a robust “Yes!” Instead, community and public college associations reportedly felt pressured by the Department to accept ITT credits that the community and public colleges deemed inadequate quality. The public and community college associations pushed back against this pressure from the Department, also expressing their strongly-held philosophical viewpoint that the Department must never seek to interfere in any academic institution’s right to be independent in its determinations of academic policy and quality, including regarding which credits it will accept for transfer from other institutions.

iii. Is Transferring the Best Option?: Closed School Discharges and Borrower Defense to Repayment

Implicit in the concept of “rescue school” for students at crumbling for-profit institutions is the assumption that transferring to a better option (a “rescue school”) is the best course of action. However, for many students, an immediate transfer is not in their best interests, as transferring precludes them from applying for a “[Closed School Discharge](#).” A Closed School Discharge enables a student who has federal student loans to discharge (or be forgiven for) those federal student loans if their school closes and they were enrolled within 120 days of the closure. The application process is fairly easy and the discharge is automatic.

Veterans who want to exercise their right to a Closed School Discharge must understand that applying and waiting for a Closed School Discharge may not be able to prevent a break in their VA housing allowance – unless they transfer to a program that is not “a comparable program at another school.” (For example, if a student transfers to a totally different program at a new school, then the student would be still eligible for the Closed School Discharge).

1. Additional Factors for Student Veterans

For student veterans, therefore, there are two conflicting options: Pursue an immediate transfer in order to keep their VA housing allowance active, or forgo an immediate transfer (at least not to a comparable program) in order to pursue a Closed School Discharge. Each veteran has to consider the balance of housing allowance vs. student loans to determine the right course, but for those with hefty federal student loans, it may be worth suffering a break in housing allowance, or transferring to an unrelated program (and possibly having to “start over”) in order to get the federal loans discharged.

2. Borrower Defense to Repayment

It is important to note that a Closed School Discharge does not help students who withdrew more than 120 days before the closure, and many students may indeed withdraw before a school closes as they grow concerned about increasing rumors and news reports of impending trouble. For example, students at ITT Tech had received warnings for many months prior to ITT’s collapse because of actions by its accreditor and the Department. Many of those students may have withdrawn earlier than 120 days prior to closure. These students may still be eligible to have their federal student loans forgiven through a “[Borrower Defense to Repayment](#)” option at the Department of Education if they can demonstrate they were defrauded by ITT Tech’s deceptive recruiting. This may well meet many students’ needs, given the evidence from federal and state investigations and lawsuits regarding ITT’s deceptive recruiting practices. Other loan forgiveness programs include those for veterans who are totally disabled, those who pursue public interest jobs, and those who were false certified for an education program.

D. What the Education Department Can Learn from Its Handling of ITT

While the Education Department handled ITT Tech significantly better than it handled Corinthian, and, indeed, heeded the critiques of its handling of Corinthian, there are still lessons we can learn from its handling of ITT. Specifically, going forward, the Department should:

- **Secure a Larger Letter of Credit Earlier:** The Department should have secured a larger Letter of Credit earlier in ITT's period of crumbling, so that, when ITT did shut down, the Department would have been left with a credit sufficient to cover the cost of Closed School Discharges to students. Instead, in the end, ED secured only \$124M prior to its August 2016 order to ITT. If all eligible students exercise their right to a Closed School Discharge, it would cost the government an estimated \$500M to forgive those loans, which means taxpayers will be left covering the majority of closed school discharges. The Department should have secured a larger letter of credit earlier. It could even have demanded a larger bond and secured immediate payment immediately before the final order denying new Title IV enrollments.

The Department should act now to ensure it currently holds letters of credit from other failing schools that are sufficiently large to cover all closed school discharges, as well as reimbursement of Pell Grants (given Sen. Patty Murray's suggestion that the Department currently has the authority to reinstate Pell Grants) and GI Bill funds. (If the Department cannot secure letters of credit sufficient to cover GI Bill funds, then VA should require letters of credit from those schools in the same proportion/percentage as the Education Department, so that if the Education Department requires 10% of a school's Title IV funds in a letter of credit, VA should require 10% of that school's GI Bill funds in a letter of credit).

- **Act Sooner Against Schools that are Financially Unstable or Have an Unsustainable Business Model:** The Department should pay attention to schools that are financially unstable, and act more quickly against them. The Department should also pay careful attention to schools with unsustainable business models – those that charge too much tuition for a subpar education, with a business model dependent on consumer fraud to entice students to attend. Such schools cannot survive if they are not artificially propped up by the Department, and, even if they are artificially propped up, they cannot last much longer given law enforcement watchdogs. It would be wise for the Department not to be caught flat-footed. For example, in the case of ITT, the Department was well aware of the August 2010 Senate Committee hearing regarding ITT's deceptive recruiting practices, as it was about the PEAKS loan program, exposed by the Senate Committee in 2011 and the subject of a February 2014 CFPB lawsuit; the SEC lawsuit in 2015; and dozens of state Attorneys General investigations and lawsuits during the same years. The Department should have acted sooner against ITT, given the evidence

of illegal deceptive recruiting. Indeed, August 2016 was fairly late to the game given the timeline of strong indicators of ITT's bad behavior.

- **Begin Now to Build Bridges to Public “Rescue Schools”:** The Department needs to act now to work with community colleges to be the “rescue schools” (or “bridge schools” or “landing schools”) for students at failing for-profit colleges, since more will fail and more students will be looking for a properly-accredited, high quality option. Currently, for-profit colleges are aggressively poaching the ITT students. (A University of Phoenix whistleblower reports that University of Phoenix is even misleading ITT students about the process of securing a Closed School Discharge, lying to students to get them to enroll at Phoenix and transfer their credits before they apply to the Education Department for their Closed School Discharge.) It would be far better for students to land at a good quality, accredited, low-tuition community college. The Department should honor community colleges’ right to determine which credits are worthy of transfer and which are not, but could nevertheless encourage community colleges to prepare for students from failing for-profit chains. Given how much more affordable community college is, requiring former ITT students to essentially start again, while a major time burden, will not in most cases be nearly as expensive as completing a degree at ITT would have been.
- **Support Community Colleges in Providing an Alternative to Subprime For-Profit Colleges:** The Department should support community colleges in innovating to ensure they can provide the flexible schedule, rolling admissions, rolling semester starts, and online education needed to meet students’ interests.
- **Support Students in Their Right to Closed School Discharge and Borrower Defense Discharge:** With a new rule announced October 27, 2016,^{xi} the Education Department will now streamline the “Defense to Repayment” Borrower Defense process for students to erase federal loans incurred because of fraud by the schools. Our coalition of advocates had urged a strong, comprehensive rule,^{xii} and we look forward to the Department’s exercising its authority for group discharges where the evidence of widespread consumer fraud exists. The Department also agreed to exercise its right to reinstate students’ Pell Grant eligibility when students’ school has closed, and to make the closed school discharge process more automatic. The Department also agreed to help students by banning arbitration clauses from school contracts.
- **Strengthen school program reviews.** In order to focus fraud-prevention efforts where fraud is most likely occurring, ED should undertake “risk-based program reviews,” of schools that:
 - currently, or in recent years, have been subject to a state or federal law enforcement action;
 - the U.S. Federal Trade Commission believes has been engaged in misleading practices;
 - have large numbers of student complaints;

- have high cohort default rates on federal loans;
 - have rapid and dramatically increased enrollment within the last few years;
 - have converted from for-profit to non-profit or vice versa within the last few years; and
 - have more than half of their programs on-line.
- **Systematically enforce existing authorities.** ED needs to more robustly enforce its current authorities. Schools often evade the cohort default rate (CDR), the 90/10 rule, and incentive compensation requirements. For example, schools manipulate their Office of Postsecondary identification (OPEID) numbers, consolidating campuses receiving more than 90 percent of their revenue from federal student aid with campuses that are below the 90 percent cap. Or, schools hire contractors to persuade students to sign up for loan deferment or forbearance in order to postpone default beyond the 3-year measurement period. These and other evasive for-profit school tactics were well documented in the Senate HELP Committee’s 2012 report. ED should:
 - Make the use of serial forbearances and spikes in defaults after the CDR window closes “triggers” to prompt an immediate investigation into possible CDR evasion, a program review, and/or an audit;
 - Issue guidance to schools on what constitutes proper default management and what constitutes CDR evasion, and on the additional steps the Department is taking to prevent both loan defaults and CDR evasion; and
 - Require continued compliance under former OPEIDs for at least three years after any change in OPEID and sanction any that would have exceeded the CDR thresholds or 90/10 threshold but for the change in OPEID.
 - **Ensure an effective, centralized student complaint system.** The Department is to be commended for its new online student complaint system. The Department should take steps to ensure the system is consumer-friendly and that response to complaints is proper and adequate (as some currently are not).
 - **Invest in stronger vocational education, technical education, and career education programs that are properly accredited.** ED needs to encourage high schools, community colleges, and state schools to make long-term investments in better career education programs. Local businesses should also be involved in long-term investment that matches education to jobs.
 - **Better Consumer Protection Information on ED websites.** Overall, the ED website and FSA and FAFSA sites fail to include consumer protection information. Most of the student-facing documents and websites at ED do not have any consumer protection information or helpful tips. Consumer protection warnings and tips should be integrated into all student-facing materials and websites. ED should also post highly visible “red flags” notices for schools prominently on College Navigator, Net Price Calculators, College Shopping Sheet, and elsewhere if they meet certain criteria, such as:
 - expenditure on instruction is less than half the tuition;
 - fails to post names and qualifications of instructors on its website;
 - does not make available the most recent accreditation self-study and visiting team reports on its website;

- fails to disclose financial benefits to its own board members or to board members of a parent entity; and
- is now, or has been in the past 5 years, the subject of state or federal law enforcement investigation or action for deceiving or abusing students or defrauding the government.
- **Combat highly deceptive and outright fraudulent marketing by predatory subprime colleges.** Require any college that spends more than 10 % of its revenue on advertising, marketing and recruiting to:
 - Report and publish on their websites the percent of revenue spent on instruction as compared to advertising, marketing, recruiting, executive compensation, and profit. ED should also make this data publicly available;
 - Record all recruiting calls and make them available for inspection by the government or third-party education reviewers, and ban recruiting calls from cell phones and on-line chats by lead generators that cannot be recorded for inspectors; and
 - Submit for review by accreditors, government, or third-party education reviewers the institution’s recruiting training manuals, videos, and materials to ensure aggressive and misleading tactics do not occur.
- **Better educate students about potential fraud.** ED has an obligation to help students avoid scams and fraud:
 - Give students “Know Before You Enroll” tips, such as those developed by the City of New York and the “8 Questions to Ask When Choosing a College After Military Service” developed by the U.S. Federal Trade Commission.
 - Show students a “Know Before You Go” warning video, such as that available on VA’s website.
 - Utilize existing paper forms, websites, trainings, and communications to alert students of the potential for fraud and educate them about how to avoid and report fraud, including through the FAFSA form (consider incorporating College Scorecard and scam alert tips such as the FTC’s “8 Questions to Ask” right into the FAFSA form).
 - Alert students to the types of deceptions and abuses that have surfaced in recent law enforcement actions—as a way of warning students.
- **Ensure appropriate program accreditation.** Protect students from being deceived by programs that lack proper accreditation or otherwise leave the students ineligible for the jobs they trained for and were promised, by requiring that
 - Schools, as a condition of institutional accreditation, only offer programs that have any accreditation legally required to participate or be licensed to work in that occupation, or typically required by employers in that field in the Metropolitan Statistical Area in which the student lives.
- **Increase transparency for consumers and enable non-governmental watchdogs to monitor schools and help uncover fraud.** In order to improve transparency and help uncover fraud, ED should:
 - Disclose 5-year CDR and repayment rates by institution;
 - Make public (posting online) more of the data and documents that ED already collects, including colleges’ required financial statements and applications for federal funds, all program participation agreements, compliance audits,

- warning letters, and all the reports schools submit to the Department, such as their default management plans; and
- Publish salary data for executives and profit data for owners/shareholders at the colleges, and add these data to the Scorecard and other ED student tools.

E. VA Also Must Act to Protect the GI Bill

The Department of Veterans Affairs (VA) also failed to act – with both ITT and Corinthian. VA demonstrated a failure to act, even in the face of pressure from other federal agencies and despite a federal statute (38 USC 3696) requiring VA to disapprove GI Bill funds to any school that has engaged in deceptive recruiting. Except for the VA's California agent (State Approving Agency) which withdrew GI Bill approval for Corinthian (affecting only California GI Bill students) earlier than the rest of VA, veterans were left unprotected by VA in either Corinthian or ITT.

Veterans face more harm from failing schools than other students because they lose their VA housing allowance within a month of a school closing. Thus, a smoother transition for veterans would be better. (On the other hand, like all students, veterans can only get the closed school discharge if they do not transfer and that means they'll have to suffer a break in housing allowance).

IV. Other For-Profit Colleges Are Financially Unstable and Have Unsustainable Business Models

Many other for-profit colleges are financially unstable, and/or have an unsustainable business model, posing a risk to the taxpayer funds that are propping them up in the overwhelming face of likely failure. What does it mean to have an unsustainable business model? It means that a company cannot expect to continue to thrive in the higher education market if it is not artificially propped up by the Department, because its tuition is inflated, its education is poor quality, and it engages in consumer fraud in order to lure students to enroll.

Such schools exist only because they are propped up by the Education Department. This propping up, is, in itself, unsustainable because exposure by the media and law enforcement of the companies' practices will lead to louder public calls for the government to stop the corporate welfare trough.

A 2012 Senate HELP Committee report examined the business model of 30 publicly traded and privately-owned for profit schools, including Corinthian. In general, the report found that these schools:

- used aggressive and misleading recruiting tactics;
- charged higher tuition than comparable public school alternatives;
- paid their CEOs exorbitant salaries;

- received the majority of their revenue from taxpayer dollars;
- devoted more of their revenue on a per-student basis to marketing, recruiting, and profits than to instruction;
- had high withdrawal rates, particularly for online programs;
- overwhelmingly depended on part-time faculty; and
- were under investigation by or had settled with numerous state Attorneys General and federal agencies over allegations concerning aggressive and misleading marketing practices and schemes resulting in students being forced to take out high-interest rate, private student loans.

The Department should look hard at schools where the publicly available business information indicates serious financial instability. The Department of Education has taken strong action recently against some mid-size institutions, such as Computer Systems Institute, but many other questionable operations remain in business, receiving tens of millions annually in taxpayer dollars. ^{xiii}

Footnotes

ⁱ <http://www.nytimes.com/2016/09/08/business/downfall-of-itt-technical-institutes-was-a-long-time-in-the-making.html>

ⁱⁱ <http://www.nytimes.com/2016/09/09/opinion/late-to-the-fight-against-predator-schools.html?mtrref=undefined&assetType=opinion>

ⁱⁱⁱ <https://static1.squarespace.com/static/556718b2e4b02e470eb1b186/t/5744b227cf80a18d18ae55a9/1464119847314/VES+memo+2.26.16+Update+2+5.23.16.pdf>

^{iv}

<https://static1.squarespace.com/static/556718b2e4b02e470eb1b186/t/5744bdfc2eeb81f2ceb68358/1464122877006/VSO+MSO+Letter+to+VA+Secretary+re+GI+Bill+oversight.Signed+%281%29.pdf>

^v http://www.nytimes.com/2016/05/22/us/politics/veterans-groups-seek-a-crackdown-on-deceptive-colleges.html?ref=topics&_r=1

^{vi} <https://www.washingtonpost.com/news/grade-point/wp/2016/09/20/devry-voluntarily-dials-back-revenue-from-federal-student-aid/>

^{vii} <http://www.nytimes.com/2011/09/22/opinion/for-profit-colleges-vulnerable-gis.html>

^{viii} http://www.huffingtonpost.com/davidhalperin/devasting-reports-itt-tec_b_12157564.html; https://www.republicreport.org/wp-content/uploads/2016/09/ESI_close_out_final.pdf

^{ix} <https://tcf.org/content/report/covert-for-profit/>

^x <http://www.bostonglobe.com/business/2015/02/17/healey-seeks-loan-forgiveness-for-students-allegedly-deceived-for-profit-schools/CGCVkNEsviTCih2DeNf54K/story.html>

^{xi} <http://www.ed.gov/news/press-releases/us-department-education-announces-final-regulations-protect-students-and-taxpayers-predatory-institutions>

xii http://www.protectstudentsandtaxpayers.org/wp-content/uploads/2016/08/BD-NPRM-Coalition-Comment_FINAL_August1_2016.pdf

xiii http://www.huffingtonpost.com/davidhalperin/education-dept-getting-fe_b_9822730.html;
http://www.huffingtonpost.com/davidhalperin/college-staffed-by-ex-tru_b_10757076.html