Incentive Compensation

Primary Statute: HEA section 487(a)(20)
Primary Regulations: 34 CFR Part 668.14(22)(i)

Background

Under the Higher Education Act of 1965, institutions of higher education participating in the federal student aid programs must agree they will not provide incentive payments to recruiters who work for or with the school in exchange for enrolling students or obtaining financial aid.

The requirements, known broadly as "incentive compensation" rules, were developed over time in response to reports of aggressive and abusive marketing and recruitment practices, particularly among for-profit postsecondary education providers. An investigation led by Senator Sam Nunn, for instance, led to a landmark 1990 report that detailed examples of such practices, including competitions with cash or other rewards for contacting the highest number of students or submitting the largest number of loan applications. The report recommended that institutions be prohibited from making payments of any commission, bonus, or salary incentive to recruiters.

In 1992, when Congress reauthorized the Higher Education Act, it adopted the recommendation of the Nunn Commission report on incentive compensation, along with other policies designed to crack down on predatory practices. The new requirement was included in the section of the law governing institutions' certification of federal student aid eligibility, so it applied to all institutions participating in the federal student aid programs authorized by Title IV of the HEA and a violation could result in a loss of Title IV eligibility. Specifically, the law stated that:

> The institution **will not provide any commission, bonus, or other incentive payment** based directly or indirectly on **success in securing enrollments or financial aid** to any persons or entities engaged in any student recruiting or admission activities or in making decisions regarding the award of student financial assistance, except that this paragraph shall not apply to the recruitment of foreign students residing in foreign countries who are not eligible to receive Federal student assistance. (emphasis added)

A conference report issued alongside the law clarified that the provision did not prohibit merit-based salary reviews generally, but rather incentive payments based solely on success in student recruitment, enrollment, or financial aid awards.

Implementation of the New Requirements

Following passage of the 1992 reauthorization, the Department of Education responded to questions, including on specifics of possible compensation plans, from institutions of higher education about the incentive compensation rules. The result of these responses were varying interpretations of the underlying provisions of the incentive compensation ban and, although of particular interest to ED's Inspector General, enforcement was minimal.

In the year 2000, the high-profile case of Computer Learning Centers (CLC) altered the landscape. The publicly traded for-profit college, accredited by the Accrediting Council for Independent Colleges and Schools (ACICS), had been under investigation by numerous state regulators and faced lawsuits from students since at least 1998, facing allegations of poor quality, misrepresentations about graduates' success in finding jobs, and fraud. In the year 2000, the Education Department issued a final program review determination that found the school had violated incentive compensation rules by basing recruiters' salaries on the average number of students they enrolled monthly, and ordered it to repay more than $185 million in federal student aid. Just a few weeks later, CLC cancelled its classes, permanently closed the institution without warning, and filed for bankruptcy.

2002 Regulations and the Hansen Memo

Shortly thereafter, the higher education association the American Council on Education (ACE) joined forces with the for-profit agency now known as Career Education Colleges and Universities (CECU) to ask for greater clarity in the regulations (and for updates to the law itself from Congress). ACE was particularly nervous about potential violations by colleges that paid external websites a referral payment for sending students to the college's website. CECU, then called the Career College Association, had been supporting a proposal with six "safe harbors" from the incentive compensation rules, although the nonprofit association did not support it at the time.

Under pressure from a newly nervous higher education industry and Congress, and with a new administration in the White House, the Education Department announced in 2001 that it would conduct a new rulemaking on the incentive compensation rules. The final rule, published in November 2002, created 12 "safe harbors," outlining compensation structures to recruiters that the Department considered *not* to violate the law. They were:

- Fixed compensation (e.g., annual salaries or hourly wages) as long as they are not adjusted more than twice during a 12-month period and that those adjustments are not based solely on the number of students recruited, admitted, enrolled, or awarded financial aid;
- Compensation based on recruitment of students into non-Title IV-eligible programs;
- Compensation to those who arrange contracts between employers and institutions in which the employer pays at least half of the tuition and fees (as long as the compensation is not based on the number of employees who enroll at the school and the recruiters don't have contact with the employees directly);

- Compensation in a profit-sharing or bonus plan as long as the payments are the same, and made to all of the institution's full-time professional and administrative staff;
- Compensation based on students successfully completing at least one academic year of their educational programs;
- Compensation for employees who do pre-enrollment work like answering phone calls or distributing materials to prospective students;
- Compensation to managers or supervisors who do not oversee employees directly involved in recruiting or admissions activities;
- Up to one annual token gift provided to students or alumni (not to exceed $100 in value, and that the gift is not in cash form);
- Profit distributions based proportionately on someone's ownership interest in the college;
- Compensation for all web-based recruitment and admission activities that refer prospective students to the institution or allow them to apply to the college online;
- Payments to any third party organizations, including through tuition-sharing, that deliver services to the institution, as long as the services don't include recruiting, admissions, and federal student aid awards; and
- Payments to any third-party organizations, including through tuition-sharing, that deliver services to the institution, including recruiting, admissions, and federal student aid awards, as long as the employees of those organizations are not compensated through incentive payments.

As those rules were being finalized, the Department also made changes to its internal practices that greatly reduced the penalty to institutions found in violation of incentive compensation rules. The "Hansen Memo," so called because it was sent from Deputy Secretary Bill Hansen to the chief operating officer of the Office of Federal Student Aid, stated that "improper recruiting does not render a recruited student ineligible to receive student aid funds for attendance at the institution on whose behalf the recruiting is conducted. Accordingly, the Department should treat a violation of the law as a compliance matter for which remedial or punitive sanctions should be considered."

Whereas the requirement had long been a condition of institutions' certification for Title IV federal financial aid eligibility, and a violation of incentive compensation rules would thus typically result in the limitation, suspension, or termination of federal financial aid eligibility, this reduced potential violations to a much smaller fine. Specifically, rather than fining institutions for the entirety of federal aid received during the illegal incentive compensation scheme which should have rendered the school ineligible for any Title IV aid, the Department would account for the amount of the illegal payments to recruiters, and would heavily weigh "the pervasiveness of the improper practices" and the "extent to which the institution appeared to be knowingly violating the law."

Between 1998 and 2010, the Department identified incentive compensation violations at 32 institutions through program reviews. An additional 22 institutions reached settlement agreements related to incentive compensation (generally reached with no admission of the violation by the college). A 2010 report from the Government Accountability Office found, among other things, that the Department's enforcement of the incentive compensation ban was inadequate. The Department's Office of the Inspector General concurred in a 2015 report saying that because of the Hansen Memo, "FSA employees were hesitant to take enforcement actions against schools that might have violated the incentive compensation ban."

2010 Regulations and the Bundled Services Guidance

When the Obama Administration came in, the Department began the process of removing the safe harbors and issuing new regulations. The Department wrote at the time that its "experience demonstrates that unscrupulous actors routinely rely upon these safe harbors to circumvent the intent of" the law. The new regulations, finalized in 2010, largely restored the original interpretation of the statute, specifying that only general merit-based salary increases (not based on success in recruiting and enrolling students) and profit-sharing payments to individuals other than those involved in recruitment were exempt from the requirements.

The next year, however, the Department issued new guidance that effectively restored one of the safe harbors from the 2002 regulations, albeit without public comment or regulatory language. The so-called "bundled services" guidance clarified (among other things) that certain types of revenue-sharing agreements between an institution and a third party could also qualify under incentive compensation rules, as was provided for in the tenth of the Bush Administration's safe harbors, provided that:

- Recruiting and enrollment work is only one of a bundled set of services that the third party provides; and
- The third party is unaffiliated with the institution.

The guidance was issued at the request of a handful of companies that were developing a new business model -- "online program management" companies (OPMs). The Department argued in its guidance that "the independence of the third party (both as a corporate matter and as a decision maker) from the institution that provides the actual teaching and educational services is a significant safeguard against the abuses the Department has seen..."

Today, the OPM industry is a multi-billion dollar one. In exchange for the OPM bearing the start-up costs of an online program, institutions often contract with OPMs for between 40 and 65 percent of all tuition revenue from the program, with some OPMs charging as much as 80 percent of revenue. Moreover, some contracts obtained by The Century Foundation and other cases that have become public indicate that such arrangements do not always maintain the required independence of the OPM as a decision-maker, with cases in which OPMs have control over curriculum decisions, admissions standards, and more. Given the growing number of institutions partnering with OPMs, some have called for the rescission or revision of the bundled services guidance, more caution on the part of institutions of higher education, and/or heightened transparency into OPM contracts. Despite these concerns, institutions, such as Schreiner University and the University of California-Berkeley, have successfully introduced new academic programs in partnership with OPMs.

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