

Elimination of the Safe Harbors for Incentive Compensation

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EXECUTIVE SUMMARY

Section 487(a)(20) of the Higher Education Act of 1965, as amended by the Higher Education Amendments of 1992, bans colleges from paying commissions, bonuses or other forms of incentive compensation based directly or indirectly on success in securing enrollments or financial aid. This restriction is included in the program participation agreement for institutional eligibility for federal student aid funds available through Title IV of the Higher Education Act of 1965 and applies to all colleges, including public, non-profit and for-profit colleges. Since 2002, the regulations at 34 CFR 668.14(b)(22)(ii) have provided a set of twelve safe harbors for activities that are deemed to not violate the restrictions on incentive compensation. During negotiated rulemaking for Higher Education 2009-10, however, the US Department of Education proposed to repeal the safe harbors because of concerns about abusive recruiting practices.¹ This paper discusses the consequences of a repeal of the safe harbors.

If the safe harbors are eliminated, colleges will need to review their compensation and advertising practices to ensure that they are consistent with the language concerning incentive compensation in the Higher Education Act of 1965. However, the elimination of safe harbor (A) may have no effect, as this safe harbor mirrors the language in the conference report from passage of the Higher Education Amendments of 1992. As such the gist of the safe harbor may persist even after it is dropped. Still, the conference report clarifies that Congress intended to ban commissioned sales representatives. Since then most of the violations of the incentive compensation prohibitions have involved violations of this safe harbor. Accordingly, more aggressive enforcement of the existing rules might be more effective than the proposed regulatory changes and should be considered instead of or in addition to the proposed regulatory changes.

Elimination of the safe harbors will mean that compensation of college employees and third parties cannot be based, in any way, on success in securing enrollments or financial aid. Many of the safe harbors provided waivers for particular functions and services.² However, the language of the statute is focused solely on the basis of the compensation and not on the nature of the services performed. So dropping the safe harbors will lead to a change in the compensation practices for functions and services previously protected by the safe harbors, if those compensation practices are based on success in securing enrollments and financial aid. For example, safe harbor (F) permitted compensation based on success in securing enrollments for clerical pre-enrollment activities. This compensation practice will no longer be

¹ See Issue Paper #4, Team I – Program Integrity Issues, pages 46-52 of www2.ed.gov/policy/highered/reg/hearulemaking/2009/integrity-session3-issues.pdf (January 20, 2010 version)

² Specifically, safe harbors (B) through (L) identified situations in which incentive compensation would not be considered a violation of the statutory prohibition.

permitted if the safe harbors are eliminated. On the other hand, if the compensation practices were not based on success in securing enrollments and financial aid, the safe harbors were irrelevant, as the statutory restrictions would not have applied regardless. For example, safe harbor (I) permitted profit distributions proportionately based on an individual's ownership interest. Since the statute restricts compensation based on success in securing enrollments and financial aid, not ownership interest, dropping this safe harbor should have no effect.

The elimination of some of the safe harbors will have a more nuanced impact:

- The elimination of safe harbor (B) will mean that colleges can no longer provide incentive compensation based on success in securing enrollments for *programs* that are ineligible for federal student aid. Instead, the standard will revert to the narrow exception included in the statute for *foreign students* who are ineligible for federal student aid.
- The US Department of Education argues that dropping safe harbor (E) will entail a ban on providing incentive compensation based on student retention and completion. The justification for this argument, however, is weak, and it may still be possible to provide incentive compensation based on retention and graduation rates, especially if the compensation is not paid to recruiting and admissions staff. However a subsequent draft of proposed regulatory language goes beyond dropping safe harbor (E), perhaps in recognition of this weakness, to actively prohibiting compensation based on success in improving student retention and completion rates and increasing financial aid application rates.
- The elimination of safe harbor (H) will probably preclude providing gifts and other compensation to students and alumni, especially in exchange for referring prospective students to the college. Providing students with promotional literature and other educational materials of negligible value will likely still be ok, especially if it is not conditioned upon enrollment.
- Dropping safe harbor (J) will preclude web sites from being compensated on a CPA basis, as payments for qualified leads clearly involve incentive compensation based on success in securing enrollments. Other compensation methods, such as flat fee subscriptions, CPM, CPC and CPL will probably still be allowed, provided that the pricing is not based on conversion rates. Colleges will still be able to pay more for preferred placement and to refuse to advertise on web sites or email campaigns that do not satisfy minimum quality standards.

The proposed regulatory changes will become effective on July 1, 2011, assuming that final regulations are published in the Federal Register no later than November 1, 2010.

CURRENT STATUTORY LANGUAGE

The current statutory language concerning incentive compensation appear in section 487(a)(20) of the Higher Education Act of 1965 [20 USC 1094(a)(20)] as part of the program participation agreement requirements:

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.

This prohibition was enacted as part of the Higher Education Amendments of 1992 (P.L. 102-325) in response to reports of abusive student recruiting practices at all types of colleges, especially the recruitment of unqualified students.

An attempt to amend this definition was included in the Internet Equity and Education Act of 2001 (107 H.R. 1992) which passed the US House of Representatives on October 10, 2001 by a vote of 354 to 70. However, the legislation was never reported out of committee in the US Senate and ultimately was not enacted. That legislation would have deleted the word “indirectly” from the statute, inserted the word “directly” before the word “engaged”, and added exceptions similar to safe harbors (C), (K) and (L) as well as the aspects of safe harbor (A) that concern fixed compensation with semi-annual reviews.

CURRENT REGULATORY LANGUAGE (2002)

The safe harbors appear in the regulations at 34 CFR 668.14(b)(22). These regulations were published in the Federal Register 67(212):67048-67083 on November 1, 2002.

- (i) It will not provide any commission, bonus, or other incentive payment based directly or indirectly upon success in securing enrollments or financial aid to any person or entity engaged in any student recruiting or admission activities or in making decisions regarding the awarding of title IV, HEA program funds, except that this limitation does not apply to the recruitment of foreign students residing in foreign countries who are not eligible to receive title IV, HEA program funds.
- (ii) Activities and arrangements that an institution may carry out without violating the provisions of paragraph (b)(22)(i) of this section include, but are not limited to:
 - (A) The payment of fixed compensation, such as a fixed annual salary or a fixed hourly wage, as long as that compensation is not adjusted up or down more than twice during any twelve month period, and any adjustment is not based solely on the number of students recruited, admitted, enrolled, or awarded financial aid. For this purpose, an increase in fixed compensation resulting from a cost of living increase that is paid to all or substantially all full-time employees is not considered an adjustment.³
 - (B) Compensation to recruiters based upon their recruitment of students who enroll only in programs that are not eligible for title IV, HEA program funds.
 - (C) Compensation to recruiters who arrange contracts between the institution and an employer under which the employer's employees enroll in the institution, and the employer pays, directly or by reimbursement, 50 percent or more of the tuition and fees charged to its employees; provided that the compensation is not based upon the number of employees who enroll in the institution, or the revenue they generate, and the recruiters have no contact with the employees.

³ Generally, cost of living adjustments are restricted to one per year. Also, overtime pay as required by the Federal Fair Labor Standards Act is not considered a violation of the incentive compensation rules provided that the base pay is not itself an incentive compensation.

- (D) Compensation paid as part of a profit-sharing or bonus plan, as long as those payments are substantially the same amount or the same percentage of salary or wages, and made to all or substantially all of the institution's full-time professional and administrative staff. Such payments can be limited to all, or substantially all of the full-time employees at one or more organizational level at the institution, except that an organizational level may not consist predominantly of recruiters, admissions staff, or financial aid staff.
- (E) Compensation that is based upon students successfully completing their educational programs, or one academic year of their educational programs, whichever is shorter. For this purpose, successful completion of an academic year means that the student has earned at least 24 semester or trimester credit hours or 36 quarter credit hours, or has successfully completed at least 900 clock hours of instruction at the institution.
- (F) Compensation paid to employees who perform clerical "pre-enrollment" activities, such as answering telephone calls, referring inquiries, or distributing institutional materials.⁴
- (G) Compensation to managerial or supervisory employees who do not directly manage or supervise employees who are directly involved in recruiting or admissions activities, or the awarding of title IV, HEA program funds.
- (H) The awarding of token gifts to the institution's students or alumni, provided that the gifts are not in the form of money, no more than one gift is provided annually to an individual, and the cost of the gift is not more than \$100.
- (I) Profit distributions proportionately based upon an individual's ownership interest in the institution.
- (J) Compensation paid for Internet-based recruitment and admission activities that provide information about the institution to prospective students, refer prospective students to the institution, or permit prospective students to apply for admission on-line.
- (K) Payments to third parties, including tuition sharing arrangements, that deliver various services to the institution, provided that none of the services involve recruiting or admission activities, or the awarding of title IV, HEA program funds.
- (L) Payments to third parties, including tuition sharing arrangements, that deliver various services to the institution, even if one of the services involves recruiting or admission activities or the awarding of title IV, HEA program funds, provided that the individuals performing the recruitment or admission activities, or the awarding of title IV, HEA program funds, are not compensated in a manner that would be impermissible under paragraph (b)(22) of this section.

PREVIOUS REGULATORY LANGUAGE (1994)

The following is the original regulatory language for 34 CFR 668.14(b)(22) from the interim final regulations published in the Federal Register on April 29, 1994. These regulations followed enactment of the statutory prohibition in the Higher Education Amendments of 1992.

It will not provide, nor contract with any entity that provides, 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

⁴ Soliciting students for interviews is considered a recruiting activity and not a pre-enrollment activity.

decisions regarding the awarding of student financial assistance, except that this requirement shall not apply to the recruitment of foreign students residing in foreign countries who are not eligible to receive Federal student assistance. This provision does not apply to the giving of token gifts to students or alumni for referring students for admission to the institution as long as: The gift is not in the form of money, check, or money order; no more than one such gift is given to any student or alumnus; and the gift has a value of not more than \$25;

PROPOSED REGULATORY LANGUAGE (2010)

The following is the revised regulatory language for 34 CFR 668.14(b)(22) as proposed by the US Department of Education at the start of the third negotiated rulemaking session for program integrity issues on January 25, 2010.⁵

It will not provide any commission, bonus, or other incentive payment based directly or indirectly upon success in securing enrollments or financial aid to any person or entity engaged in any student recruiting or admission activities or in making decisions regarding the award of student financial assistance, except that this paragraph does not apply to the recruitment of foreign students residing in foreign countries who are not eligible to receive Federal student assistance.

This proposed regulatory language closely mirrors the statutory language and drops all of the safe harbors.

The following is subsequent revised regulatory language for 34 CFR 668.14(b)(22) as proposed by the US Department of Education and revised by the non-federal negotiators and the US Department of Education. It was presented at the third negotiated rulemaking session for program integrity issues on January 29, 2010, the last day of the session, but consensus was not reached.

- (i)
 - (A) Except as expressly provided in paragraph (b)(22)(ii) of this section, it will not provide any commission, bonus, or other incentive payment based directly or indirectly upon success in securing enrollments or the award of financial aid to any person or entity who is engaged in any student recruitment or admission activity, or in making decisions regarding the award of student financial aid.
 - (B) The restrictions in paragraph (b)(22) of this section do not apply to the recruitment of foreign students residing in foreign countries who are not eligible to receive Federal student assistance.
- (ii) Eligible institutions, organizations that are contractors to eligible institutions, and other entities may make merit-based adjustments to employee compensation provided that such adjustments are not based on success in securing student enrollments or the award of financial aid.
- (iii) As used in paragraph (b)(22) of this section,
 - (A) "Commission, bonus or other incentive payment" means a sum of money or something of value paid to or given to a person or an entity because of the success in securing student enrollments or the award of financial aid.
 - (B) "Securing student enrollments or awards of financial aid" means direct or indirect activities that a person or entity engages in for the purpose of the admission or matriculation of a student for any period of time or the award of financial aid to a student.

⁵ www2.ed.gov/policy/highered/reg/hearulemaking/2009/integrity.html

- (1) These activities include recruitment contact in any form with a prospective student, such as pre-admission or advising activities, scheduling an appointment to visit the enrollment office, attendance at such appointment, or signing an enrollment agreement or financial aid application.
 - (2) These activities do not include making a payment to a third party for the provision of student contact information for prospective students provided that such payment is not based on the number of students who apply or enroll.
- (C) "Enrollment" means the admission or matriculation of a student into an eligible institution.

This draft regulation not only drops the safe harbors but also imposes several new prohibitions. Some of these changes seem to go beyond interpreting and implementing the plain language of the law as enacted and as intended by Congress into the realm of making new law.

The draft regulation provides an exception for merit-based salary adjustments that are not based on success in securing enrollments and financial aid. This exception is narrower than the previous safe harbor (A) and broadens the scope of the restrictions from the "commission, bonus or other incentive payment" language in the statute to all forms of merit-based adjustments to compensation.⁶ It also omits the limitation to employees that are "engaged in any student recruiting or admission activities or in making decisions regarding the award of student financial assistance," thereby expanding the scope to all employees of the college, and explicitly defines "securing student enrollments or awards of financial aid" as including "direct or indirect activities" engaged in for the purpose of admission or matriculation of a student.⁷ The language in the proposed regulation also appears intended to oppose and obviate the previous use of the word "solely" in safe harbor (A) since it precludes basing compensation in any way on success in securing enrollments and financial aid.⁸

The draft regulation also provides three definitions. The second definition includes language that would explicitly ban activities previously permitted by safe harbor (E) for retention and completion and safe harbor (F) for clerical pre-enrollment activities.

- The addition of "for any period of time" in the proposed regulation at 34 CFR 668.14(b)(22)(iii)(B) precludes compensation based on retention and completion rates.

⁶ Commissions and bonuses are one-time payments. The term "adjustments to compensation" includes raises, which are permanent increases in salary. Commissioned sales staff are more likely to receive one-time performance-based bonuses than permanent raises. The proposed regulations expand the types of compensation that will be subject to the prohibition. The proposed regulations do not, however, appear to restrict fixed base compensation, just adjustments to compensation. It is unclear how initial base compensation could be based on merit, except perhaps by one college trying to lure a star recruiter away from a competing college by offering a large salary based on the recruiter's previous success in securing enrollments at the competing college.

⁷ The "directly or indirectly" language of the statute applies to the basis of the compensation, not to the involvement in student recruiting, admissions and financial aid activities. If Congress intended for the prohibition to apply to people with an indirect involvement in these activities – effectively all faculty and staff at the college – it would have included the words "directly or indirectly" immediately before the word "engaged" in a manner similar to the proposed regulation.

⁸ This change is probably in conflict with the intent of Congress, which used the word "solely" in the conference report of the Higher Education Amendments of 1992, as discussed below in "Impact of the Proposed Changes".

- The “admission or matriculation of a student” language in the proposed regulation at 34 CFR 668.14(b)(22)(iii)(B) would expand the statutory restriction on securing enrollments to a regulatory ban on success in admitting students.^{9 10}
- The addition of “signing ... [a] financial aid application” in the proposed regulation at 34 CFR 668.14(b)(22)(iii)(B)(1) precludes compensation based on success in encouraging students to apply for student financial aid.
- The language in the proposed regulation at 34 CFR 668.14(b)(22)(iii)(B)(1) specifies that clerical pre-enrollment activities are not excepted from the statutory restrictions.
- The language in the proposed regulation at 34 CFR 668.14(b)(22)(iii)(B)(2) would permit Internet-based lead generation operations provided that the compensation is not based on application or enrollment rates. This would preclude CPA-based advertising, since CPA-based advertising compensates based on the number of “qualified” leads such as the number of applications or the number of students who enroll. It would permit other common compensation methods provided that the fees were not based in any way on conversion rates.

The draft regulations, if they become final, will probably increase the number of qui tam lawsuits under the False Claims Act of 1986 since they expand the scope of the statutory prohibition and are included in the Program Participation Agreement section of the Higher Education Act of 1965. The targets of such qui tam lawsuits will probably expand to include non-profit colleges in addition to for-profit colleges. It is likely that some of the qui tam lawsuits will attempt to argue that specific merit-based compensation plans violate the exception at CFR 668.14(b)(22)(ii) since many forms of compensation can be construed as being indirectly based on success in securing enrollments and the award of financial aid.¹¹

MOTIVATION FOR THE CHANGES

The primary motivation for the proposed regulatory changes is in response to reports of abuse. The US Department of Education wrote in Issue Paper #4 that “The Department has received complaints from students and enrollment advisors about the high-pressure sales tactics of some postsecondary institutions. Some argue that tying staff compensation to the number of students enrolled is an inherent conflict of

⁹ Note that this language and the addition of the word “apply” to the proposed regulations expand the statutory ban on securing enrollments to also include a ban on securing applications. Some non-selective colleges admit every student, so an application to an open enrollment college might be considered the equivalent of an offer of admission. However, not all admitted students ultimately enroll at the college, so applications are not necessarily the equivalent of enrollments. This is not analogous to the prohibited inducements rules for education lenders banning the payment of inducements based on the number of dollar volume of funded loans as opposed to applications, since the introduction of the Master Promissory Note blurred and telegraphed the distinction between applications and funded loans.

¹⁰ However, the conference report on the Higher Education Amendments of 1992 discussed the number of students “recruited, admitted, enrolled, or awarded financial aid” providing an indication of Congressional intent to include admissions in addition to enrollments within the scope of the ban.

¹¹ For example, colleges that pay football coaches a bonus for winning the national championship might be construed as violating the proposed regulations since winning the national championship increases college application rates by an average of 8% the next year. Individual colleges have reported increases in the number of applications as high as 59% for success in football and basketball competitions. See Devin G. Pope and Jaren C. Pope, *The Impact of College Sports Success on the Quantity and Quality of Student Applications*, Southern Economic Journal 75(3):750-780, January 2009, and Chad McEvoy, *The Impact of Elite Individual Athletic Performance on University Applicants for Admission in NCAA Division I-A Football*, The Sport Journal 9(1), 2006.

interest¹² and that the safe harbors undermine the statutory ban on incentive compensation.” Several policy analysts at the US Department of Education have said that the safe harbors added in the 2002 negotiated rulemaking created loopholes that permitted compensation practices contrary to the intent of the law. Eliminating the safe harbors might reduce opportunities for abuse.

Without the regulatory safe harbors, the rules concerning incentive compensation will revert to the statutory language and other evidence of Congressional intent. The US Department of Education’s position as stated in Issue Paper #4 reflects this: “the specific language of the statute is clear and that elimination of all of the regulatory “safe harbors” would best serve to effectuate congressional intent.”

Safe harbor (A) defines what is and is not considered to be incentive compensation while safe harbors (B) through (L) identify situations in which incentive compensation would not be considered as violating the statutory prohibition. The US Department of Education’s discussion of these safe harbors argues that there is too much room for abuse in the first safe harbor and that the remaining safe harbors are either not necessary, prone to manipulation, or inconsistent with the core statutory language that bans compensation “based directly or indirectly on success in securing enrollments or financial aid.”

IMPACT OF THE PROPOSED CHANGES

If the US Department of Education’s proposed regulatory changes become final, colleges will no longer be able to rely on the safe harbors and will need to review their compensation and advertising practices. This will occur largely in a vacuum concerning acceptable and unacceptable practices.¹³ Some colleges may adopt a conservative approach, while others may decide to test the limits of the new regulations. The US Department of Education may ultimately publish some guidance to add clarity to the enforcement of the statute, but this will not happen immediately. The US Department of Education is also unlikely to drop the safe harbors from the regulations only to restore them in subregulatory guidance. Instead, the guidance will probably identify specific examples of inappropriate practices. Any permissive guidance will probably be narrow in scope.

The restrictions on incentive compensation apply to all colleges, not just for-profit colleges, as the statutory ban is included in the program participation agreement. As noted in a 2010 US Government Accountability Office (GAO) report, abuses have occurred at every type of college, including public, non-profit and for-profit colleges.

Generally, most of the US Department of Education’s proposed regulatory changes will not be prone to court challenge as their proposal amounts to dropping a set of waivers that are largely inconsistent with the statutory language, as opposed to imposing a new set of restrictions. The main exceptions are the merit-based pay adjustment exception and the second of the two definitions included in the draft released on the last day of negotiated rulemaking. These aspects of the last draft appear to impose new restrictions that go beyond the plain language of the statute and Congressional intent. However, any newly imposed restrictions in the final regulations that are not clearly supported in the plain language of the statute or

¹² Compensating recruiters based on the number of enrollments provides them with a financial incentive to enroll each *individual* student even if the student will not benefit from enrolling in college or would be better off enrolling at a different institution.

¹³ It may be possible to draw some insights from the discussion in the NPRM and final rulemaking when they are published in the Federal Register.

which appear to be arbitrary or vague may also be subject to challenge. Likewise, specific enforcement actions may still be subject to challenge to the extent that they go beyond the statutory language and other evidence of Congressional intent. For example, some aspects of safe harbor (A) are consistent with Congressional intent, as discussed below, and will likely survive the elimination of the safe harbors. It is unclear whether any court challenges would ultimately prove to be successful, but litigation seems likely.¹⁴

Safe Harbor (A)

The US Department of Education's discussion of safe harbor (A) expresses concern about compensation arrangements in which the compensation is based on the number of starts¹⁵ but where the institution argues that the compensation is not based *solely* on the number of enrolled students. The US Department of Education argues that in some cases the salaries are in fact based exclusively on the number of enrolled students, notwithstanding any claims by the institution that it considers other factors. (Such a sham basis for compensation clearly violates the statute and the safe harbor, but may be difficult to prove.)

The issues addressed by safe harbor (A) are critical, as a 2010 US Government Accountability Office (GAO) report¹⁶ found that most of the substantiated incentive compensation violations between 1998 and 2009 “involved payments by schools to their staff in the form of bonuses or commissions for successfully enrolling students in the school.”

However, dropping safe harbor (A) will not adequately address the abuses identified by the US Department of Education and the GAO. The word “solely” reflects Congressional intent as discussed in the conference report for the Higher Education Amendments of 1992 (P.L. 102-325), since the word “solely” is used in the conference report.¹⁷ As such, dropping the safe harbor may have no effect. Substituting more restrictive language may also have no effect, to the extent that that language conflicts with the evidence of Congressional intent presented in the conference report. Still, the conference report provides insights into Congress's concerns about abuse by commissioned sales representatives and clearly indicates that Congress intended to ban the use of commissioned sales representatives. Accordingly, clarification and enforcement of the existing rules may be more effective in preventing abuse than dropping the safe harbor. Actions speak louder than words. The following is an excerpt of the relevant text from the conference report's discussion of the statutory ban on incentive compensation:

The Senate bill eliminates any institution from Title IV eligibility that uses commissioned salespeople in any phase of its operation. The House bill adds a similar prohibition to the program participation agreements section but applies the limitation to the enrollment, recruitment, admissions and financial aid process.

The conference substitute applies the limitation to the enrollment, recruitment, admissions and financial aid process, places it in the program participation agreement section and provides an

¹⁴ Court challenges of US Department of Education regulations are successful only in rare circumstances. Given that there are a minimum of nine months between publication of the final rule and its implementation, the courts are also unlikely to grant colleges an injunction against these and the other program integrity regulations.

¹⁵ The number of newly enrolled students is often referred to as “starts” in the college recruiting industry.

¹⁶ *Higher Education: Information on Incentive Compensation Violations Substantiated by the U.S. Department of Education*, GAO-10-370R, February 23, 2010. www.gao.gov/products/GAO-10-370R

¹⁷ Conference Report to accompany S.1150, Report 102-630, June 29, 1992.

exemption for the use of commissioned sales in foreign countries for purposes of recruiting foreign students who do not meet the definition of eligible student under this title. The conferees note that substantial program abuse has occurred in the student aid programs with respect to the use of commissioned sales representatives. Therefore this legislation will prohibit their use. The conferees wish to clarify, however, that use of the term "indirectly" does not imply that schools cannot base employee salaries on merit. It does imply that such compensation cannot **solely** be a function of the number of students recruited, admitted, enrolled, or awarded financial aid. The conferees have provided a limited exception permitting the use of commissioned sales representatives for the recruitment of foreign students to U.S. institutions on the basis that such students are not eligible for Title IV assistance. Recruitment of such students falls beyond the scope of federal interest in preserving the integrity of student aid programs and are therefore not relevant to the granting of institutional eligibility under the Act.

In a 2008 court case, *United States of America ex rel. Bott v. Silicon Valley Colleges*, No. 06-15423, 262 Fed. Appx. 810, 2008 WL 59364, at *1 (9th Cir. Jan. 4, 2008),¹⁸ the Ninth Circuit court interpreted the Higher Education Act of 1965 (as opposed to the safe harbors) as barring compensation based *solely* on recruitment success and that the statute did not prohibit “salary reviews generally” or the termination of employees who did not achieve enrollment quotas.

The Act does not prohibit salary reviews generally, but rather bars the payment of a “commission, bonus, or other incentive payment” solely on the basis of recruitment success. ... The decision to fire an employee is not covered by the Act because termination is not a prohibited “commission, bonus, or other incentive payment.”

However, the court did suggest that a salary review system that was merely a “sham mechanism for funneling improper incentive pay” (i.e., salary reviews that were in fact based solely on recruitment success) would be a violation of the statute.

Safe Harbors (C), (D), (F), (G), (I), (K), (L)

Dropping safe harbors (C), (D), (F), (G), (I), (K) and (L) will require that the compensation for the specified activities is not based, in any way, on success in securing enrollments or financial aid. The language of the statute is focused on the basis of the compensation and not the nature of the services performed. Waivers for particular types of services are not supported by a plain language reading of the statute.

Safe Harbor (B)

Safe harbor (B) concerns incentive compensation for recruiters of students who enroll in programs that are not eligible for federal student aid. But the statute bans basing incentive compensation on success in securing enrollments in addition to success in securing financial aid, so the safe harbor is in conflict with the statutory language. Dropping this safe harbor will revert to the narrow exception explicitly provided by Congress for recruiters of foreign students who are ineligible for federal student aid. The difference is that the safe harbor is focused on all students and *programs* that are ineligible for federal student aid while the statute is focused just on foreign students and *students* who are ineligible for federal student aid.

¹⁸ [archive.ca9.uscourts.gov/coa/memdispo.nsf/pdfview/010408/\\$File/06-15423.PDF](http://archive.ca9.uscourts.gov/coa/memdispo.nsf/pdfview/010408/$File/06-15423.PDF)

The statutory language “who are not eligible to receive Federal student assistance” acts to narrow the exception, not define it, contrary to the rationale originally used to justify the safe harbor.

Safe Harbor (E)

Safe harbor (E) concerns incentive compensation based on student retention and completion. The US Department of Education argues that retention and completion presupposes enrollment and as such could be considered as being indirectly based on success in securing enrollments. The US Department of Education wrote “unless the student enrolls, the student cannot successfully complete an educational program” in arguing that compensation based on completion is indirectly based on securing enrollments.¹⁹ The US Department of Education also highlights the potential for abuse and manipulation. This is similar to the position taken in the discussion section of the original 1994 NPRM:

The Secretary is aware that some institutions pay incentives to recruiters or admissions office employees based on the success of those persons in enrolling students, provided that the enrolled students maintain satisfactory progress for and remain enrolled in the institution for a specified period of time. The Secretary considers this practice, which commonly is referred to as an incentive based on “retention,” to be an example of an activity that is prohibited by the statute.

However, a similar argument could be raised against almost every type of compensation provided by a college to its faculty and staff. For example, one might argue that unless a student enrolls, the student cannot attend class, and therefore all forms of compensation for teaching faculty are indirectly based on success in securing enrollments. One could use similar logic to argue for the exclusion of compensation based on customer satisfaction surveys such as course evaluation surveys, since only enrolled students would complete such surveys and as such the survey would be indirectly based on success in securing enrollments. Similarly, one could argue against basing compensation for the campus bookstore staff on the number of books sold, since book sales correlate with and depend upon enrollment.

A similar argument could also be used to conclude that colleges cannot compensate faculty and staff (financial aid office staff in particular) based on success in encouraging current and prospective students to submit the Free Application for Federal Student Aid (FAFSA) or other financial aid applications. For example, one could argue that success in encouraging students to submit a financial aid application represents indirect success in securing financial aid since a student cannot receive financial aid if the student does not apply. One could also argue that success in encouraging students to complete financial aid applications falls under the “indirect” prohibition on securing enrollments, as interpreted by the US Department of Education, since students who apply for financial aid are more likely to continue and complete their education.

Perhaps in recognition of this weakness, the US Department of Education proposed explicit restrictions against compensation based on retention and completion and success in encouraging students to apply for financial aid. The addition of the “for any period of time” language in the proposed regulation at CFR

¹⁹ This statement is the contrapositive of “if a student successfully completed an education program, then the student enrolled,” a style of reasoning that includes all direct or indirect entailments of enrollment within its scope. The absurdity of this syllogism is apparent if one notes that enrollment entails payment of the bursar’s tuition bill, so collection of tuition revenue could be construed as representing indirect success in securing enrollments. Likewise for the collection of parking permit fees or any other activity applied to enrolled students.

668.14(b)(22)(iii)(B) would preclude compensation based on retention and completion rates. The proposed regulation at 34 CFR 668.14(b)(22)(iii)(B)(1) bans basing compensation upon the signing of a financial aid application and not just upon the award of financial aid.²⁰ If the statute speaks for itself, then why are additional restrictions necessary in the regulations?

A stronger potential argument against basing incentive compensation on retention (but not necessarily completion) would note that the statute bans basing incentive compensation on success in securing enrollments without specifying whether the enrollments involve new or returning enrollments. Thus a strict reading of the statutory language would ban compensation of recruiting and admissions staff based on retention rates but not necessarily graduation rates. However, the statutory language restricts the recipients of the compensation to “any persons or entities engaged in any student recruiting or admission activities” which suggests a focus on new enrollments, not retention.

But retention and completion are not naked proxies or even hyponyms for enrollment, and a strict reading of the statutory language does not ban such practices nor does it ban compensation based on success in encouraging students to apply for financial aid.²¹ However, the final version of the proposed regulations would adopt such restrictions. For example, the language “for any period of time” in the proposed regulation at 34 CFR 668.14(b)(22)(i)(B) would preclude compensation based on retention and completion rates and the language “signing ... [a] financial aid application” in 34 CFR 668.14(b)(22)(i)(B)(1) would preclude compensation based on success in encouraging students to apply for financial aid.

The proposed regulations do not discuss basing incentive compensation on other related measures of student performance, such as job placement rates or default rates, so it may still be possible to compensate recruiting and admissions staff based on those alternate measures of student quality. However, former students can only get a job and default on their student loans if they were enrolled in the college at some point in time, so the US Department of Education’s expansive syllogism might preclude such forms of merit-based compensation as well.

It is clear that Congress did not intend to ban all compensation practices, rather just those that involved commissioned sales. To the extent that Congress itself established satisfactory academic progress in

²⁰ Under this proposed regulation college faculty and staff - and financial aid staff in particular - could continue to encourage current and prospective students to apply for financial aid, but they could not receive incentive compensation based on their success in encouraging students to apply for financial aid. This regulation could also potentially be construed as banning compensation based on the performance of outreach activities, if this interpretation of the statute is taken to an extreme.

²¹ A plain language definition of “indirect” involves intermediate or intervening structural or semantic linkages, such as company A indirectly owning company C through its ownership of company B which in turn owns company C. In a similar vein, counting the number of eyeballs indirectly counts the number of people since most people have two eyes. The term “indirect costs” is used by OMB to refer to allowable overhead charges in government contracts, where the costs are lumped into an overall indirect cost rate and not specifically itemized. The US Department of Education appears to be expanding the definition of indirect to include a chain of consequences with seemingly arbitrary distinctions among different types of causal relationships. To some extent the US Department of Education appears to be using the word “indirect” in a transformative sense. A child who is allergic to eggs cannot eat cake that uses eggs as an ingredient, even if they are uniformly mixed and cooked during the baking process. But an egg elimination diet does not translate into a ban on all cakes, as cakes that use egg substitutes such as applesauce will not trigger the allergy.

section 484(c) of the Higher Education Act of 1965 as a prerequisite for a student's continued receipt of federal student aid, attempts by the US Department of Education to enforce a ban on compensation based on retention and completion (without clear statutory or regulatory support for such a ban) might not survive court challenge, especially if the compensation incorporates meaningful qualitative standards. Likewise, it is clear that Congress did not intend to ban colleges from participating in outreach activities such as TRIO, Talent Search, Upward Bound, Student Support Services, Educational Opportunity Centers, GEAR UP and related programs (or from compensating the staff that manage these programs based directly or indirectly on successful outcomes), as the statutory language in section 487(a)(20) of the Higher Education Act of 1965 does not begin with "notwithstanding any other provision of this title" or "notwithstanding any other provision of law."

Rewarding meaningful improvements in retention and graduation rates and encouraging students to apply for student financial aid is consistent with good public policy. For example, before he was Deputy Undersecretary at the US Department of Education, Robert Shireman proposed providing colleges with a bounty when a Pell Grant recipient graduates in a 2004 column in the Chronicle of Higher Education.²² Borrowers who drop out are three times more likely to default than borrowers who graduate, so improving completion rates will reduce default rates.²³ Ongoing research on performance-based scholarships by MDRC has demonstrated that providing students with more immediate rewards for academic performance yields improvements in retention rates.²⁴

Similarly, until 34 CFR 668 Appendix D "Default Reduction Measures" was removed on November 1, 2000²⁵ because it is "outdated and no longer used for the primary purposes for which it was developed,"²⁶ it encouraged colleges to base recruiter compensation on retention and completion:

To reduce defaults, the Secretary recommends that the institution take the following measures:

5. Implement a compensation structure for commissioned enrollment representatives and salesmen under which a representative or salesman earns no more than a nominal commission for enrolling students that never attend school, and progressively greater commissions for students who remain in school for substantial periods.

Safe Harbor (H)

Safe harbor (H) is similar in concept to the safe harbor for education lenders in 34 CFR 682.200(b) "Lender" (5)(ii)(J) that permits lenders to provide "Items of nominal value to schools, school-affiliated organizations, and borrowers that are offered as a form of generalized marketing or advertising, or to create good will." However, the \$100 threshold in safe harbor (H) is much higher than what is normally considered to be a nominal amount.²⁷ In addition, Congress has recently demonstrated clear opposition to

²² Robert Shireman, *What Would Higher Education Do With \$6 Billion a Year?*, Chronicle of Higher Education 50(41), June 18, 2004. chronicle.com/weekly/v50/i41/41b01701.htm

²³ Pages 8-9 of Mark Kantrowitz, *What is Gainful Employment? What is Affordable Debt?*, March 1, 2010. Updated March 1, 2010. www.finaid.org/educators/20100301gainfulemployment.pdf

²⁴ www.mdrc.org/project_31_91.html

²⁵ Federal Register 65(212):65650, November 1, 2000

²⁶ Federal Register 65(149):47600, August 2, 2000

²⁷ The National Association of Student Financial Aid Administrators defines nominal value using a \$10 threshold in its student loan code of conduct. The original 1994 incentive compensation regulations specified a \$25 threshold.

allowing incentives to influence student actions.²⁸ Section 140(f)(2) of the Truth in Lending Act, as amended by the Credit CARD Act of 2009, bans credit card issuers from offering students tangible items to induce them to apply for a credit card.

If safe harbor (H) is dropped, gifts to a student might be construed as incentive compensation and so would be prohibited under the statute unless they are not in any way predicated on the student's enrollment in the college. For example, colleges may still give prospective students promotional literature and relevant educational materials, provided that the materials are of clearly nominal value and comply with other restrictions concerning misleading statements and substantial misrepresentations. On the other hand, payments or gifts to students or alumni for referring other prospective students to the college will be clearly prohibited.

Safe Harbor (J)

Safe harbor (J) concerns compensation for Internet-based recruitment and admissions activities.²⁹ These activities include providing information about the college to prospective students, referring prospective students to the college and providing online applications for admission. Internet-based advertising for colleges typically involves either a link to the college's web site or a link to a form that solicits contact information ("leads") for delivery to the college. Paid advertising is currently compensated using a variety of methods that are often interchangeable based on conversion rates:

- **Subscription.** The web site is paid a flat fee for a specified time period, regardless of the number of visitors delivered to its web site or the number of leads received.
- **CPM.** The web site is paid based on the number of *impressions* of a display advertisement, such as a banner or tower advertisement (i.e., an image display in a horizontal or vertical orientation), a text link or the number of recipients of an email campaign.
- **CPC.** The web site is paid based on the number of *clicks* on a display advertisement or text link. This is the compensation method used by Google and other web search engines.³⁰
- **CPL.** The web site is paid based on the number of *leads* delivered, such as the number of requests for more information or the number of applications for admission. The leads are unqualified,

²⁸ One might argue that this a change in Congressional intent, however.

²⁹ Monster Worldwide, the parent company of FinAid and FastWeb, owns web properties that accept advertising from colleges and universities. The author of this report is not involved in business development for these sites.

³⁰ While Google may be compensated based on CPC, it appears that Google assigns advertisement placement based on a ranking that combines keyword-relevance and the equivalent CPM rate. An advertisement with a low click-through rate (CTR) may increase its ranking by paying a higher CPC rate. The CPM rate is the normalized product of the CPC rate with the CTR. However, Google provides tools that advertisers can use to calculate conversion rates by tracking the percentage of clicks that arrive on a particular destination web page. These tools could be used to calculate equivalent CPA-based rates by tracking the number of successfully submitted applications for admission using an online college admission application form. However, such CPA rates would be based on success in securing applications, not enrollments, and so would not be precluded by the statute. Nevertheless such CPA-based compensation would not be permitted by the proposed regulations at 34 CFR 668.14(b)(22)(iii)(B)(2) which preclude basing compensation on the number of applications in addition to the number of enrollments.

meaning that there is no evaluation of lead quality or the conversion from unqualified to qualified leads, except perhaps for the discarding of duplicate leads. CPL-based compensation is based on success in securing unqualified leads (e.g., contact information) but not qualified leads (e.g., enrollments).

- **CPA.** The web site is paid based on site visitors or leads taking a specified *action*, such as enrolling in the college or some other revenue-generating event. Such leads are often referred to as qualified. For example, the web site might be paid based on the number of leads that ultimately enroll in the college.

The fees sometimes vary based on preferential placement (e.g., above the fold or in the top-ranked location). For example, advertisers pay a higher CPC rate on Google for placement on the first page of search results or above the natural search engine results and for better ranking or positioning among the advertisements. Advertisements with a higher rank generate more clicks than advertisements with a lower rank or which do not appear on the first page of search results.

Web sites prefer to be compensated based on CPM, since this reflects the effectiveness of the use of available space for displaying advertising. Higher CPM rates usually translate into higher revenues. Some newspaper web sites prefer CPM-based advertising because it avoids the potential for a conflict of interest. Advertisers, on the other hand, prefer to pay compensation based on CPA, since this reflects the effectiveness of the advertising in delivering qualified leads. Even when an advertising contract specifies CPA-based compensation or other performance-based compensation, the web sites analyze effectiveness internally based on the equivalent CPM-rate and optimize advertisement placement based on CPM.

If safe harbor (J) is dropped, CPA-based compensation of web sites for college advertising will be prohibited because such advertising represents direct compensation based on success in securing enrollments. This is regardless of whether the web site (or an affiliated call center) is involved in the actual enrollment of students or not, as the statute is focused on the basis of the compensation, not the services performed. In addition, the pricing for the other compensation methods should in no way be based on the rate of conversion from impressions, clicks or unqualified leads into qualified leads, because such advertising represents indirect compensation based on success in securing enrollments. The proposed regulatory language in 34 CFR 668.14(b)(22)(iii)(B)(2) would permit web sites to provide “student contact information for prospective students provided that such payment is not based on the number of students who apply or enroll.” (Similarly, call centers could be compensated based on outbound call volume, but not on the success in securing applications or enrollments.)

Since colleges will not be able to pay web sites based on lead quality, they will no longer be able to control costs by negotiating lower rates for lower quality lead sources. As a result, colleges are likely to abandon lead sources that deliver low quality leads, such as mailing list brokers and so-called “arbitrage” sites. Instead, the colleges will concentrate on higher volume web sites that are more relevant and which surpass minimum quality standards.³¹ Compensation methods will shift to CPM, CPC, CPL and subscription models, especially if the rates are dictated by the web sites and not the colleges.

³¹ The colleges might also consider other factors in determining lead sources, such as the impact of each lead source’s leads on the college’s compliance with the 90/10 rule and the proposed gainful employment rules.

Note that the statutory language prohibits a college from paying incentive compensation based on success in securing enrollments and financial aid. It does not prohibit employees, web sites or other entities from receiving such compensation. Thus any enforcement actions will be targeted at colleges that provide such incentive compensation and not necessarily at the employees or web sites that receive this compensation. The web sites are therefore likely to rely on the colleges to specify which compensation methods are acceptable. Most web sites lack the expertise to identify potential violations of the statute and do not monitor subregulatory guidance published by the US Department of Education.

TIMING OF THE CHANGES

If the proposed regulatory changes are to become effective on July 1, 2011, the US Department of Education must publish final regulations in the Federal Register no later than November 1, 2010. It is possible that the US Department of Education will publish the NPRM³² as early as June 2010 with a 30 or 60 day public comment period. This will give the US Department of Education enough time to draft the final regulations before the November 1 deadline. (The US Department of Education has the option of publishing interim final regulations between the publication of the NPRM and the final regulations to provide more opportunity for public comment. But this would result in a tighter schedule if the US Department of Education wants to publish final regulations before the November 1 deadline.) However, historically three-quarters of all NPRMs have been published in July, August and September and a much smaller percentage in June.

³² Proposed regulations are published in a Notice of Proposed Rulemaking (NPRM).