

Issue Paper #4

Team I – Program Integrity Issues

Issue: Incentive Compensation
Statutory cites: HEA section 487(a)(20)
Regulatory cites: 34 CFR 668.14(b)(22)
Summary question(s): Should the “safe harbors” be reexamined?

Summary of issue: The HEA provides that to be eligible to participate in the Federal student financial aid programs authorized under title IV, an institution must enter into a program participation agreement with the Secretary. The agreement includes a number of conditions with which an institution must comply to be granted initial and continuing eligibility to participate. Among those conditions is a prohibition on institutions providing any commission, bonus, or other incentive payment based directly or indirectly on 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. This limitation shall not apply to the recruitment of foreign students residing in foreign countries who are not eligible to receive Federal student assistance.

The regulations implementing this provision of the HEA specify 12 types of payment and compensation plans that do not violate this statutory prohibition. The first safe harbor explains the conditions under which an institution may adjust compensation without that compensation being considered an incentive payment.

The remaining 11 safe harbors describe the conditions under which payments that could potentially be construed as based upon securing enrollments or financial aid are nonetheless not covered by the statutory prohibition.

The payment or compensation plans covered by the safe harbors cover the following subjects:

1. Adjustments to employee compensation. Under this safe harbor, an institution may make up to two adjustments (upward or downward) to a covered employee’s annual salary or fixed hourly wage rate within any 12-month period without the adjustment being considered an incentive payment, provided that no adjustment is based solely on the number of students recruited, admitted, enrolled, or awarded financial aid. One cost-of-living increase that is paid to all or substantially all of the institution’s full-time employees will not be considered an adjustment under this safe harbor. In addition, with regard to overtime, if the basic compensation of an employee is not an incentive payment, neither is overtime pay required under the Federal Fair Labor Standards Act.
2. Enrollment in programs that are not eligible for title IV, HEA program funds. An institution may provide incentive compensation to recruiters based upon their recruitment of students who enroll only in programs that are not eligible for title IV, HEA program funds.

3. Contracts with employers to provide training. This safe harbor addresses payments to recruiters who arrange contracts between an institution and an employer, where the employer pays the tuition and fees for its employees (either directly to the institution or by reimbursement to the employee). As long as there is no direct contact by the institution's representative with prospective students, and as long as the employer is paying at least 50% of the training costs, incentive payments to recruiters who arrange for such contracts are not covered by the incentive payment prohibition, provided that the incentive payments are not based on the number of employees who enroll, or the amount of revenue generated by those employees.
4. Profit-sharing bonus plans. Profit-sharing and bonus payments to all or substantially all of an institution's full-time employees are not incentive payments based on success in securing enrollments or awarding financial aid. As long as the profit-sharing or bonus payments are substantially the same amount or the same percentage of salary or wages, and as long as the payments are made to all or substantially all of the institution's full-time professional and administrative staff, compensation paid as part of a profit-sharing or bonus plan is not considered a violation of the incentive payment prohibition. In addition, such payments can be limited to all or substantially all of the full-time employees at one or more organizational levels at the institution, except that an organizational level may not consist predominantly of recruiters, the admissions staff, or the financial aid staff.
5. Compensation based upon program completion. Compensation that is based upon students successfully completing their educational programs, or one academic year of their educational programs, whichever is shorter, does not violate the incentive compensation prohibition. 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. (Time may not be substituted for credits earned.) In addition, the 30 weeks of instructional time element of the definition of an academic year does not apply to this safe harbor. Therefore, this safe harbor applies when a student earns, for example, 24 semester credits, no matter how short or long a time that takes.
6. Pre-enrollment activities. Generally, clerical pre-enrollment activities are not considered recruitment or admission activities. Accordingly, an institution may make incentive payments to individuals whose responsibilities are limited to pre-enrollment activities that are clerical in nature. However, soliciting students for interviews is a recruitment activity, not a pre-enrollment activity, and individuals may not receive incentive compensation based on their success in soliciting students for interviews. In addition, since a recruiter's job description is to recruit, it would be very difficult for an institution to document that it was paying a bonus to a recruiter solely for clerical pre-enrollment activities.
7. Managerial and supervisory employees. This safe harbor recognizes that the incentive payment prohibition applies only to individuals who perform activities related to recruitment, admissions, enrollment, or the financial aid awarding process and their immediate supervisors. Direct supervisors are included in this prohibition because their actions generally have a direct and immediate impact on the individuals who carry out these covered activities.

8. Token gifts. Under this safe harbor, the regulations provide that a token gift not to exceed \$100 may be provided to an alumnus or student provided that the gift is not in the form of money and no more than one gift is provided annually to an individual. The cost basis of a token noncash gift is what the institution paid for it. The value is the fair market value of the item. The fair market value of an item might be considerably greater than its cost. A high value item for which the institution paid a minimal cost would not be considered a token gift.
9. Profit distributions. Profit distributions to owners are not payments based on success in securing enrollments or awarding financial aid. Therefore any owner, whether an employee or not, is entitled to a share of the organization's profits to the extent they represent a proportionate share of the profits based upon the employee's ownership interest.
10. Internet-based activities. This safe harbor permits an institution to award incentive compensation 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 online.
11. Payments to third parties for non-recruitment activities. This safe harbor recognizes that the incentive payment prohibition applies only to activities dealing with recruiting, admissions, enrollment, and financial aid. Therefore, an institution may make incentive payments to third parties for other types of services, including tuition sharing arrangements, marketing, and advertising that are not covered by the incentive compensation prohibition.
12. Payments to third parties for recruitment activities. If an institution uses an outside entity to perform activities for it, including covered activities, the institution may make incentive payments to the third party without violating the incentive payment prohibition as long as the individuals performing the covered activities are not compensated in a way that is prohibited by the incentive payment compensation rule. For example, if an institution established a group of employees who provided the institution with a series of services, and one of those services was recruiting, the incentive compensation prohibition would preclude only the individuals doing the recruiting from being paid on an incentive basis. If that institution hired a contractor to provide these services, the same rules would apply. The outside entity could not pay the individuals performing the recruiting services on an incentive basis, but it could pay the other employees performing non-recruiting activities on an incentive basis.

Comments and questions

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 interest and that the safe harbors undermine the statutory ban on incentive compensation. The Department has also heard from a number of educational institutions that the lack of clear guidance prior to establishment of the safe harbors made it very difficult for institutions to be confident of their compliance with the rule.

Should the safe harbors be maintained, amended, or eliminated in whole or in part from the regulations?

Updated information since November meeting:

1. Consistent with the majority of the comments made by the participants, the Department believes that the specific language of the statute is clear, and that the elimination of all of the regulatory “safe harbors” would best serve to effectuate congressional intent. The following specific comments are offered regarding each of the currently existing 12 “safe harbors.” (Hereinafter, each “safe harbor” is designated by the letter that corresponds to the regulatory citation, 34 C.F.R. § 668.14(b)(22)(ii)).
2. Pursuant to “safe harbor” (A), institutions are permitted to award thrice-annual salary adjustments (one based on the cost of living), as long as these adjustments are not based *solely* on the number of students recruited. This “safe harbor” has led to allegations in which an institution concedes that its compensation structure includes consideration of the number of enrolled students, but avers that it is not *solely* based upon such numbers. In some of these instances, the substantial weight of the evidence has suggested that the other factors purportedly analyzed are not truly considered, and that, in reality, the institution bases salaries exclusively upon the number of students enrolled. In addition, changing the word *solely* to some other modifier would not ameliorate this concern as the evaluation of any alternative arrangement would likely then merely shift to whether the compensation was “primarily” or “substantially” based upon enrollments.
3. “Safe harbor” (B) permits compensation to recruiters based upon enrollment of students who enroll in programs that are ineligible for Title IV funds. The statute provides that compensation may not be based upon success in securing enrollments whether the students receive Title IV funds, or some other form of student financial assistance. The statute provides for only one exception, and that addresses foreign students residing in foreign countries.
4. “Safe harbor” (C) exempts compensation to recruiters based upon the arrangement of contracts with employers under certain circumstances that result in the enrollment of the employer’s employees in the institution. The compensation provided, however, is ultimately based upon success in securing enrollments, and is thus inconsistent with the statutory language.
5. “Safe harbor” (D) addresses compensation paid as part of a profit-sharing or bonus plan under certain conditions. There is no statutory proscription upon offering employees either profit-sharing or a bonus; however, if either is based upon success in securing enrollments, it is not permitted.
6. “Safe harbor” (E) permits compensation based upon students successfully completing their educational program. Such compensation is “indirectly” based upon securing enrollments-- unless the student enrolls, the student cannot successfully complete an educational program, and with the proliferation of short-time, accelerated programs, the potential exists for shorter and shorter programs, and increased efforts to rely upon this ‘safe harbor’ to incentivize recruiters. This safe harbor may lead to lowered or

misrepresented admissions standards and program offerings, lowered academic progress standards, altered attendance records, and a lack of meaningful emphasis on retention.

7. "Safe harbor" (F) states that compensation based upon clerical "pre-enrollment" activities is permitted under the statute. Such activities certainly contribute "indirectly" if not "directly" to the success in securing enrollments, and hence compensation based upon them is prohibited by the statute. Moreover, with the elimination of "safe harbor" (A), an unscrupulous actor could claim that the activities in which its recruiters' engaged, and for which they were compensated, consisted of "clerical" or "pre-enrollment" activities, regardless of whether a student ultimately enrolled.
8. "Safe harbor" (G) permits compensation to managers and supervisors based upon success in securing enrollments as long as the person receiving the compensation does not directly manage or supervise employees directly involved in recruitment activities. Senior management may drive the organizational and operational culture at an institution, creating pressures for top, and even middle, management to secure increasing numbers of enrollments from their recruiters. As a result, these individuals are not exempt from the ban on receiving incentivized compensation.
9. "Safe harbor" (H) permits the payment of one-time annual non-monetary gifts that do not exceed \$100 to students or alumni. As at least one participant noted, students oft-times do things with little reflection if it brings an immediate reward, and such things as a \$100 gift card constitute a substantial incentive for many students.
10. "Safe harbor" (I) states that profit distributions proportionately based upon an individual's ownership interest are permitted. The statute prohibits compensation based upon success in securing enrollments, not based upon an individual's ownership interest. Profit distributions based directly or indirectly upon success in securing enrollments is all that is proscribed.
11. "Safe harbor" (J) permits compensation paid for Internet-based recruitment and admission activities. This form of recruitment is not exempt from the statutory ban on incentive compensation. Technological advancements and developments in Internet-based activities since this "safe harbor" was adopted, and the frequency with which such activities are now relied upon, creates further cause for concern.
12. "Safe harbors" (K) and (L) address payments made to third parties-- (K), where the third party provides no recruiting or admission activities, or the awarding of Title IV funds, and (L), where the third party does provide recruiting or admission activities, or the awarding of Title IV funds, as long as none of the individuals providing these activities is paid in a fashion that violates the law. It should not matter what the third party is doing-- it cannot be compensated directly or indirectly based upon the success in securing enrollments. Thus, there is no reason to provide any discussion of third-party activities as a potential "safe harbor."

Updated information since December meeting: Awaiting suggestions from non-federal negotiators.

1 **Draft Regulatory Language**

2

3 | §_668.14(b)(22)(~~⊕~~) It will not provide any commission, bonus, or other incentive payment based
4 | directly or indirectly upon success in securing enrollments or financial aid to any person or entity
5 | engaged in any student recruiting or admission activities or in making decisions regarding the
6 | awarding of ~~student financial assistance, title IV, HEA program funds~~, except that this ~~limitation~~
7 | ~~paragraph~~ does not apply to the recruitment of foreign students residing in foreign countries who
8 | are not eligible to receive ~~Federal student assistance, title IV, HEA program funds~~.

9 | ~~(ii) Activities and arrangements that an institution may carry out without violating the provisions~~
10 | ~~of paragraph (b)(22)(i) of this section include, but are not limited to:~~

11 | ~~(A) The payment of fixed compensation, such as a fixed annual salary or a fixed hourly wage, as~~
12 | ~~long as that compensation is not adjusted up or down more than twice during any twelve-month~~
13 | ~~period, and any adjustment is not based solely on the number of students recruited, admitted,~~
14 | ~~enrolled, or awarded financial aid. For this purpose, an increase in fixed compensation resulting~~
15 | ~~from a cost-of-living increase that is paid to all or substantially all full-time employees is not~~
16 | ~~considered an adjustment.~~

17 | ~~(B) Compensation to recruiters based upon their recruitment of students who enroll only in~~
18 | ~~programs that are not eligible for title IV, HEA program funds.~~

19 | ~~(C) Compensation to recruiters who arrange contracts between the institution and an employer~~
20 | ~~under which the employer's employees enroll in the institution, and the employer pays, directly~~
21 | ~~or by reimbursement, 50 percent or more of the tuition and fees charged to its employees;~~
22 | ~~provided that the compensation is not based upon the number of employees who enroll in the~~
23 | ~~institution, or the revenue they generate, and the recruiters have no contact with the employees.~~

24 | ~~(D) Compensation paid as part of a profit-sharing or bonus plan, as long as those payments are~~
25 | ~~substantially the same amount or the same percentage of salary or wages, and made to all or~~
26 | ~~substantially all of the institution's full-time professional and administrative staff. Such payments~~
27 | ~~can be limited to all, or substantially all of the full-time employees at one or more organizational~~
28 | ~~level at the institution, except that an organizational level may not consist predominantly of~~
29 | ~~recruiters, admissions staff, or financial aid staff.~~

30 | ~~(E) Compensation that is based upon students successfully completing their educational~~
31 | ~~programs, or one academic year of their educational programs, whichever is shorter. For this~~

1 ~~purpose, successful completion of an academic year means that the student has earned at least 24~~
2 ~~semester or trimester credit hours or 36 quarter credit hours, or has successfully completed at~~
3 ~~least 900 clock hours of instruction at the institution.~~

4 ~~(F) Compensation paid to employees who perform clerical "pre-enrollment" activities, such as~~
5 ~~answering telephone calls, referring inquiries, or distributing institutional materials.~~

6 ~~(G) Compensation to managerial or supervisory employees who do not directly manage or~~
7 ~~supervise employees who are directly involved in recruiting or admissions activities, or the~~
8 ~~awarding of title IV, HEA program funds.~~

9 ~~(H) The awarding of token gifts to the institution's students or alumni, provided that the gifts are~~
10 ~~not in the form of money, no more than one gift is provided annually to an individual, and the~~
11 ~~cost of the gift is not more than \$100.~~

12 ~~(I) Profit distributions proportionately based upon an individual's ownership interest in the~~
13 ~~institution.~~

14 ~~(J) Compensation paid for Internet-based recruitment and admission activities that provide~~
15 ~~information about the institution to prospective students, refer prospective students to the~~
16 ~~institution, or permit prospective students to apply for admission on-line.~~

17 ~~(K) Payments to third parties, including tuition sharing arrangements, that deliver various~~
18 ~~services to the institution, provided that none of the services involve recruiting or admission~~
19 ~~activities, or the awarding of title IV, HEA program funds.~~

20 ~~(L) Payments to third parties, including tuition sharing arrangements, that deliver various~~
21 ~~services to the institution, even if one of the services involves recruiting or admission activities~~
22 ~~or the awarding of title IV, HEA program funds, provided that the individuals performing the~~
23 ~~recruitment or admission activities, or the awarding of title IV, HEA program funds, are not~~
24 ~~compensated in a manner that would be impermissible under paragraph (b)(22) of this section.~~

25
26