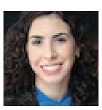
THIRD WAY

LETTER *Published March 16, 2023 • 11 minute read*

Comments to the Department of Education on the Incentive Compensation Prohibition



Michelle Dimino
Deputy Director of Education
@MichelleDimino

Lanae Erickson
Senior Vice President for Social Policy, Education & Politics
@LanaeErickson

March 16, 2023

Ms. Ashley Clark

US Department of Education
400 Maryland Ave. SW
Washington, DC 20202

Docket ID: ED-2023-OPE-0030

Dear Ms. Clark:

Thank you for the opportunity to offer written comment to the Department of Education regarding the incentive compensation prohibition under Title IV of the *Higher Education Act*. The prohibition on incentive compensation was put in place in 1992 with the clear and important goal of protecting students from predatory recruiting practices incentivized by commission payments for securing enrollment. However, the bundled services loophole created in 2011 has undermined the ban's intended purpose, heightening students' risk of being subject to unscrupulous recruiting tactics and high tuition charges for educational programs of questionable quality. Third Way is pleased to see the Department revisiting its bundled services guidance as part of its ongoing efforts to safeguard the investment of students and taxpayers in our higher education system. Tremendous shifts in online education and outsourcing trends have occurred in the decade since the bundled services loophole was opened, and it is time for the Department to rescind the flawed guidance that created it and fully enforce the incentive compensation ban.

The need for a straightforward and thorough policy prohibiting incentive compensation was clear when the ban was first instituted and remains clear today. Financial incentives tied to meeting enrollment quotas incentivized bad actors to misrepresent institutional quality and typical student outcomes and employ relentless "call center" tactics to pressure vulnerable students into enrolling. Such aggressive, misleading, and fraudulent recruiting behavior, which was especially well-documented at predatory for-profit institutions, sparked bipartisan outrage that led to the codification of the incentive compensation ban in the 1992 HEA reauthorization.

Yet the statutory ban on incentive compensation payments has been subject to decades' worth of regulatory and sub-regulatory ping pong ever since—with students in the crosshairs. In 2002, the Department published guidance that weakened the consequences of noncompliance with the incentive compensation prohibition by categorizing violations as "a compliance matter" and positing that a monetary fine should "much more commonly" be the corresponding sanction, rather than revocation or suspension of access to federal student aid dollars. [1] Shortly thereafter, the Department released safe harbor regulations outlining twelve protected payment arrangements that schools were permitted to enter into without fear of violating the statute—including allowing incentive payments and tuition-sharing agreements with third parties involved in recruiting activities, as long as those outside employees were not compensated based "directly or indirectly" on securing student enrollment or financial aid. [2] In 2010, these safe harbors were rescinded, and the Obama Administration undertook a rulemaking process to reinstate and strengthen the original incentive compensation ban.

Less than a year later, however, the Department issued new guidance that diluted the ban once again by creating the bundled services loophole. Under the 2011 loophole, which was carved out in response to heavy lobbying by the then-nascent Online Program Management (OPM) industry, the Department permits payment to be made based on the amount of tuition generated by an institution to "an unaffiliated third party that provides a set of services that may include recruitment" without violating the incentive compensation ban. [3] As a result, OPMs were given a hall pass to enter into tuition-sharing agreements with institutions that include incentivized recruiting payouts—against the clear letter and intent of the law—so long as they were also providing other services, like technology support, marketing, or student advising.

This loophole has since grown large enough to encompass hundreds of college-OPM arrangements and thousands of educational programs. While insufficient data make it challenging to fully understand the scale and scope of these arrangements, the Government Accountability Office (GAO) noted in its 2022 report "Education Needs to Strengthen Its Approach to Monitoring Colleges' Arrangements with Online Program Managers" that at least 550 institutions have OPM contracts to support at least 2,900 certificate and degree programs. [4] The GAO report also summarized two sources of survey data reflecting the most common services provided by an OPM: student recruiting, program marketing, and marketing analytics, respectively, were the top three responses from one survey, while marketing online programs, market research, and recruiting students came out on top in the other. OPMs lobbied for a loophole by arguing that their technical expertise and online platforms were needed to help colleges ramp up high-quality online education offerings—and the bundled services guidance, in turn, was designed to allow recruiting as just one piece in the bigger pie of provided services. Yet in reality, OPMs predominantly act as high-powered marketing and recruiting machines on behalf of the colleges and universities with which they contract. Worse, common recruiting practices are often deceptive and nontransparent to students, who for their part see flashy university-branded landing pages, emails from non-affiliated recruiters using -.edu school email addresses, and phone calls engineered to come from the college's area code—with no outward signals or disclosures that such communication, let alone the academic program itself, is not being delivered 100% by the school to which they send their tuition check. [5]

Analyses of OPM contracts by The Century Foundation have also brought to light considerable concerns about the nature of tuition-sharing agreements, level of OPM involvement in the academic content of contracted programs, and common recruiting practices, including that [6] :

- OPM tuition-sharing agreements typically involve a revenue share of about 50% of tuition, but range as high as 80% or more in some contracts.
- Nearly 70% of contracts analyzed gave the OPM responsibility for developing the course.
- Nearly one-third of contracts analyzed gave the OPM responsibility for providing course instruction.
- Over half of contracts analyzed had durations of five years or more, often with complicated terms for termination or renegotiation.

These are but some examples of alarming evidence raised through analyses of current contracts, Congressional investigations, and testimonials from students aggressively recruited and left feeling duped by OPM programs or institutions locked into arduous and harmful contract terms. Many such perspectives were voiced during last week's listening sessions. With the integrity of Title IV programs and student and taxpayer interests at stake, it is clear the Department must rescind the bundled services loophole created through its 2011 guidance DCL GEN-11-05 and ensure that incentive compensation payments tied to securing student enrollment or financial aid dollars are not permissible in any form or under any circumstances, as the HEA intended.

In its request for comment, the Department posed questions related to the potential outcomes of such a decision—including how changing third-party servicer contracts from the currently predominant revenue-sharing model to a fee-for-service model would impact the services provided, and to what extent the transition to fee-for-service would impact institutions' ability to create or expand online education offerings. These are important questions to consider—and fortunately the OPM industry, leaders of which often tout innovation and adaptability as core principles of their business model, has been considering and preparing for this potential reality for years.

The OPM 2U noted in its US Securities and Exchange Commission Form 10-Q filing from the second quarter of 2014 (the oldest report accessible on its website): "We must also be able to successfully execute our business strategy while navigating constantly changing higher education laws and regulations applicable to our clients and, in some cases to ourselves, particularly the incentive compensation rule that prohibits making incentive payments related to student acquisition." In several additional clauses in the filing, 2U further acknowledged the potential for Congressional or agency actions to impact its business model and indicated the fragility of revenue-sharing given its basis in the bundled services guidance. For example [7] :

- "The adoption of any laws or regulations that limit our ability to provide our bundled services to our clients could compromise our ability to drive revenue through their programs or make our solutions less attractive to them. Congress could also enact laws or regulations that require us to modify our practices in ways that could increase our costs. In addition, regulatory activities and initiatives of the DOE may have similar consequences for our business even in the absence of Congressional action. The DOE is conducting an ongoing series of rulemakings intended to assure the integrity of the Title IV programs. No assurances can be given as to how any new rules may affect our business." (Page 45)

- "Our current business model relies heavily on the bundled services rule to enter into tuition revenue-sharing agreements with client colleges and universities. Because the bundled services rule was promulgated in the form of agency guidance issued by the DOE in the form of a ''dear colleague'' letter, or DCL, and is not codified by statute or regulation, there is risk that the rule could be altered or removed without prior notice, public comment period or other administrative procedural requirements that accompany formal agency rulemaking. (Pages 45-46)

- "The revision, removal or invalidation of the bundled services rule by Congress, the DOE or a court, whether in an action involving our company or our clients, or in action that does not involve us, could require us to change our business model and renegotiate the terms of our client contracts." (Page 46)

Similar language and acknowledgement of the risks involved in a business model based on revenue sharing are repeated in subsequent 2U financial reports, clearly laying out for shareholders and the public that reliance on the bundled services provision could impact the company's results, contract offerings, and revenue year-over-year.

It is evident that OPMs have operated with clear-eyed awareness that the bundled services loophole could be altered or rescinded at any time, and with little warning, since its inception. As a result, most OPMs, including 2U, already offer institutions the option of fee-for-service arrangements instead of traditional tuition-sharing terms. Under a fee-for-service model, institutions pay a set rate for the specific "unbundled" services for which they are contracting with the OPM, allowing for a clearer set of expectations of their ultimate costs. Wiley, iDesign, Emerge, and other OPMs have several years of documented experience entering fee-for-service contracts with client institutions; a case study on Wiley's website about the model touts that "Fee-for-service projects give you the right support—right now." [8]

OPMs have the infrastructure in place to offer alternative models to tuition-sharing and have been savvy in continually expanding the variety of partnerships they offer as appeal grows among institutions for shorter-term contracts with clearer terms and costs. For example, a cost proposal offered by the OPM Pearson to the University of Montana presents three possible compensation models: a revenue-share model, a fee-for-service model, and an expense-offset model that combines features of the revenue-share and fee-for-service arrangements. [9] In this proposal, Pearson declines to provide comparably detailed cost information for its fee-for-service option as it does for its revenue-share model (under which as much as 65% or more of revenue could go to the OPM for a full-service bundle), however the document notes that revenue-share contracts typically involve longer terms of 8-15 years, while fee-for-service contracts typically have shorter terms of 1-3 years. This is a considerable distinction for schools, as longer contracts stand to impact their risk of reliance on the OPM and their ability to be agile in responding to shifting student and labor market needs over time.

Should the bundled services guidance be rescinded, many current OPM contracts will need to be renegotiated to shift from revenue-share models to fee-for-service or other arrangements. However, this is a potential reality that the OPM industry has been preparing for over the last decade, including through the development and evolution of other payment structures that will allow OPMs to retain business and continue providing a set of services desired by colleges. Far from signaling the downfall of the industry and the end of the benefits OPMs can offer to their institutional partners, rescinding the guidance will instead allow OPMs to operate on sounder legal footing and provide institutions the opportunity to intentionally review the contracts into which they have entered with OPMs, renegotiate unfavorable terms, and establish arrangements that ultimately provide greater value and clearer costs—while better protecting their students from the well-documented risks of incentive compensation based on recruitment.

As the Department considers next steps associated with closing the bundled services loophole, it should aim to prioritize clarity, align guidance with federal law, and ensure consistent enforcement of the statutory incentive compensation prohibition going forward.

We thank you again for your efforts to address the risks posed to students and taxpayers by the bundled services loophole and allowing this opportunity for public comment. Should you have any further questions about our comments, please do not hesitate to contact us.

Sincerely,

Michelle Dimino
Deputy Director of Education
Third Way
mdimino@thirdway.org

Lanae Erickson
Senior Vice President, Social Policy, Education & Politics
Third Way
lerickson@thirdway.org

TOPICS

HIGHER EDUCATION 632

ENDNOTES

1. Hansen, William. “Enforcement policy for violations of incentive compensation prohibition by institutions participating in student aid programs.” Memorandum to Terri Shaw, 30 Oct. 2002, *US Department of Education*, http://www.hmbr.com/wp-content/uploads/2015/06/Hansen-Incentive-Compensation-Memo.pdf.

2. Iritani, Katherine. “Higher education: Information on incentive compensation violations substantiated by the US Department of Education.” Memorandum to The Honorable Tom Harkin, The Honorable Michael B. Enzi, The Honorable George Miller, and The Honorable John P. Kline, 23 Feb. 2010 (Rev. 12 Mar. 2010), *US Government Accountability Office*, https://gao.gov/new.items/d10370r.pdf.

3. “Program integrity questions and answers – Incentive compensation.” *US Department of Education*, www2.ed.gov/policy/highered/reg/hearulemaking/2009/compensation.html; Shireman, Robert. “The Sketchy Legal Ground for Online Revenue Sharing.” *Inside Higher Ed*, 30 Oct. 2019, www.insidehighered.com/digital-learning/views/2019/10/30/shaky-legal-ground-revenue-sharing-agreements-student-recruitment.

4. “Higher Education. Education Needs to Strengthen Its Approach to Monitoring Colleges’ Arrangements with Online Program Managers” (GAO-22-104463). *US Government Accountability Office*, 05 Apr. 2022, https://www.gao.gov/products/gao-22-104463.

5. Bannon, Lisa, and Rebecca Smith. “That Fancy University Course? It Might Actually Come From an Education Company.” *The Wall Street Journal*, 06 Jul. 2022, https://www.wsj.com/articles/that-fancy-university-course-it-might-actually-come-from-an-education-company-11657126489.

6. Hall, Stephanie, and Taela Dudley. “Dear Colleges: Take Control of Your Online Courses.” *The Century Foundation*, 12 Sep. 2019, https://tcf.org/content/report/dear-colleges-take-control-online-courses/.

7. All bulleted quotations from 2014 Q2 Form 10-Q, accessible via the Investor Relations: Quarterly Results page of 2U’s website: https://investor.2u.com/reports-and-filings/quarterly-results/default.aspx.

8. Busta, Halle. “What 2U’s Year of Change Says About the State of Online Learning.” *Higher Ed Dive*, 19 Dec. 2019, https://www.highereddive.com/news/what-2us-year-of-change-says-about-the-state-of-online-learning/569478/; Lieberman, Mark. “Competing Models Among OPM Providers.” *Inside Higher Ed*, 25 Oct. 2017, https://www.insidehighered.com/digital-learning/article/2017/10/25/opms-fee-service-growing-revenue-share-models-dominate; “Fee-for-Service Projects Give You the Right Support—Right Now.” *Wiley University Services*, 4 Oct. 2022, https://universityservices.wiley.com/fee-for-service-partnerships-case-study/.

9. Cost proposal for services submitted from Pearson to University of Montana, retrieved from: https://www.umt.edu/provost/docs/Cost%20Proposal.pdf.