

insights

TYPES NOT MAPPED YET February 22, 2023 | TTR not mapped yet | Christopher T. Murray, Scott Z. Goldschmidt, Aaron D. Lacey

ED issues significant third-party servicer guidance and launches review of Incentive Compensation Rule

The U.S. Department of Education made important [announcements](#) regarding oversight of “third-party servicers” and enforcement of its incentive compensation rule. In this post, we consider each of these announcements and their likely impact on the regulated community.

Third-party servicer guidance (UPDATED: February 28, 2023)

First, the Department introduced [significant proposed](#) changes to its third-party servicer (TPS) guidance in the form of a newly published Dear Colleague Letter ([GEN-23-03](#)).

Pursuant to statute, a TPS is an entity or individual that administers any aspect of an institution’s participation in the Title IV programs (see 20 U.S.C. §1088(c) and 34 CFR 668.2). Any provider deemed a TPS must comply with a range of requirements, discussed below.

Most significantly, the new guidance takes the position that “most activities and functions performed by outside entities on behalf of an institution are intrinsically intertwined with the institution’s administration of the Title IV programs and thus the entities performing such activities are appropriately subject to TPS requirements.” This interpretation dramatically expands the universe of entities and vendors that might be considered a TPS and, as such, subjected to the concomitant requirements.

Increasing the universe of entities that constitute a TPS also could prove highly problematic for postsecondary vendors with foreign ties. In the Dear Colleague Letter, the Department observes that “[t]o protect the interests of institutions, taxpayers, and students, an institution may not contract with a TPS to perform any aspect of the institution’s participation in a Title IV program if the servicer (or its subcontractors) is located outside of the United States or is owned or operated by an individual who is not a U.S. citizen or national or a lawful U.S. permanent resident.”

This prohibition, taken together with the Department’s expanded definition of TPS, would seem to implicate virtually all foreign companies serving institutions of higher education. It certainly raises immediate concerns regarding relationships with foreign contractors and recruiters, as well as with foreign institutions and organizations that are, each semester, performing activities and functions for domestic institutions as part of their study abroad programs.

Initially, the Department took the position that the guidance promulgated in GEN-23-03 was effective immediately. Per a February 28, 2023 update, the Department established a future effective date for this guidance of September 1, 2023. Until September 1, 2023, previous TPS guidance (Dear Colleague Letters and Q&As published in 2012, 2015, 2016, and 2017) remain in effect at which point it will be rescinded.

The Department is accepting written comments on the guidance through **March 30, 2023** through [regulations.gov](#) (Docket ID [ED-2022-OPE-0103-0002](#)). We encourage institutions and vendors to submit comments and concerns. In the updated Dear Colleague Letter itself, Department noted that they are “especially interested in comments on the impact of continuing the existing limitation on institutions contracting with third-party servicers operating outside the United States or owned or operated by individuals who are not U.S. citizens, nationals, or permanent residents, including how to address the Department’s concerns about the ability to hold such servicers liable if necessary.”

It is also important to note that the Department has [noticed](#) its intent to promulgate new TPS regulations. We expect to see drafts of this proposed rule later this year.

In addition to considering comments, institutions and vendors should be reviewing the new guidance to determine the impact on their service relationships. Special attention should be paid to the examples in the guidance under the headings "Recruitment- and Application Related Activities" and "Computer Services/Software and Record Maintenance." The examples listed will likely capture a number of vendors not currently considered to be a TPS.

Institutions have until September 1, 2023 to report any arrangements with TPS that have not previously been reported to the Department. Moreover, entities that meet the definition of a third-party servicer under the new guidance will be required to submit the Third-Party Servicer Data Form by September 1, 2023.

Finally, as noted above, any provider deemed a TPS must comply with a range of requirements. Institutions and vendors in TPS relationships must have a written agreement that includes the required contract terms outlined at [34 CFR 668.25\(c\)](#) and that accurately and specifically details the functions that the servicer and its subcontractor(s), if applicable, will perform on behalf of the institution, as well as the functions that will or must be completed by the institution.

Institutions, for their part, must obtain a signed Certification By Lower Tier Contractor form from each TPS and ensure each TPS is reported to the Department. Vendors must complete and keep current the new TPS Data [Form](#), comply with [FTC](#) information security requirements, agree to comply with FERPA if education records are received or used, and have an independent auditor conduct a compliance audit of its administration of the functions or services that it performs on behalf of eligible institutions in accordance with procedures in the [OIG's audit guide](#).

Incentive Compensation

As regular REGucation readers are no doubt aware, the Higher Education Act prohibits institutions of higher education from providing a commission or bonuses to individuals or entities based on success in securing enrollment or financial aid (the Incentive Compensation Ban). In 2011, the Department released a [Dear Colleague Letter](#) that provides guidance on the Incentive Compensation Ban. In this letter, the Department observed that it generally views tuition-sharing arrangements with third-parties providing recruiting services as prohibited because they are effectively payments based on success in recruitment. However, the letter also created an exception for third parties providing a bundled set of services, which can include recruitment, so long as the tuition-share is based on the provision of all the services. For an in-depth review of the current incentive compensation rule, please see Thompson Coburn's webinar: [Examining ED's Incentive Compensation Rule \(thompsoncoburn.com\)](#)

Last week, the Department announced the opportunity for stakeholders to participate in virtual listening sessions or provide written comments regarding proposed changes to its existing guidance concerning the incentive compensation ban. In particular, the Department is seeking guidance "on the benefits and disadvantages of the exception for bundled services, how the guidance has impacted institutions and students, and how the Department can better ensure compliance with the prohibition on incentive compensation."

This development was not unexpected. The Department's oversight of the Incentive Compensation Ban and the bundled services exemption has recently been scrutinized. For example, in April 2022 the GAO issued a report finding that the Department had not been providing sufficient instructions to auditors and institutions to detect potential violations of the incentive compensation ban (see our blog post on the report [here](#)), and in December 2022, several congressional Democrats wrote a [letter](#) encouraging ED to take further action on incentive compensation and bundled services.

The Department will be hosting listening sessions on **March 8 and 9 from 1 - 4pm EST** for stakeholders to provide verbal comments on the Incentive Compensation Ban and bundled services exception. Those interested should send an email to margo.schroeder@ed.gov. Individuals who wish to observe the listening sessions are required to register [here](#).

The Department also will be accepting written comments on the same topics through **March 16, 2023**, via [regulations.gov](#) (Docket ID [ED-2023-OPE-0030](#)).

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