



National Association for College Admission Counseling

Guiding the way to higher education

NACAC Policy Brief: Incentive Compensation

NACAC was formed in 1937 to foster ethical practices on the part all stakeholders in the high school to college transition. As an outgrowth of this mission, NACAC has established fundamental principles for ethical practice in college admission. Among these is the principle that admission counselors are professional members of their institution's staff, and as such their compensation must take the form of a fixed salary rather than commissions or bonuses based on the number of students enrolled. Reducing the basis for compensation to the number of students enrolled introduces an incentive for recruiters to actively ignore the student's interest in the transition process, and invites complications similar to those that preceded the enactment of the 1992 Higher Education Act (HEA) ban on incentive compensation.

In the 1992 reauthorization of the HEA, Congress codified a strict ban on commissioned "sales" in college admission. However, as recent media reports and Department of Education compliance actions have shown, there appear to be a significant number of institutions operating in violation of this strict ban. We urge Congress and the administration to protect students from "high pressure sales" tactics, and to protect the integrity of student financial aid programs.

The 1992 HEA Ban

[An] institution will not provide any commission, bonus, or other incentive payment based directly or indirectly on success in ensuring 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. (20 USC §1094(a)(20))

Issue Timeline

1980 – 1992

Some for-profit colleges abuse student aid programs by using high-pressure sales tactics to enroll students under false pretenses, yielding no educational benefit to students, and resulting in losses of hundreds of millions of dollars to students and taxpayers through defaulted loans and wasted financial aid

1992

Congress enacts a ban, under the Higher Education Act, on paying commissions to admission and financial aid officers

1999 – 2001

The Office of Inspector General of the U.S. Department of Education (ED) finds violations at multiple institutions (most not-for-profit) that had contracts with Apollo Group for recruiting students

2001 – 2002

- ED conducts negotiated rulemaking during which 12 "safe harbors" to the incentive compensation ban are proposed
- Among safe harbors are provisions directly addressed at "resolving" OIG penalties; participants in negotiated rulemaking are unable to reach consensus on proposed changes
- Despite lack of consensus, "safe harbors" are enacted in the Code of Federal Regulations

- ED Office of Inspector general issues “non-concurrence” statement, indicating disagreement with enactment of safe harbors

2003 – 2006

- Various federal agencies, including ED, SEC, and FTC launch investigations into for-profit colleges for violations of Higher Education Act and other federal laws; ED announces \$9.8 million settlement with Apollo Group, citing multiple and flagrant violations of ban on incentive-based recruiting and admission
- CBS news show *60 Minutes*, *Arizona Republic*, *New York Times*, *Financial Times*, *Portland Oregonian*, and other media report on alleged recruitment violations in the for-profit sector
- Regular news reports from news sources nation wide illustrate a return to the fraudulent practices of the past and subsequent legal action taken by students and shareholders

New Twist: The Stock Market

Public stock offerings of for-profit education institutions have been eagerly embraced by Wall Street. One company’s stock prices reached nearly \$100 per share before the announcement of the settlement with ED, after which the price plummeted to \$63 per share. The pressure to show ever-increasing enrollments creates an environment for unscrupulous practices. In a recent press release, on company that operates 67 primary campuses in 24 states, stated, “We expect double-digit enrollment growth going forward.” Other for-profit institutions, routinely tout record enrollments as a way of shoring up stock prices. By way of comparison, the Department of Education projects only five percent growth in enrollment for postsecondary institutions over the next five years.

NACAC Member Priorities

NACAC members recommended to Congress to reaffirm the ban on incentive compensation, and to improve enforcement of that ban in the next reauthorization of the Higher Education Act. NACAC members believe the ban is important because:

- 1. Commissioned “sales” of college admission produces incentives for unethical behavior.** Reducing the basis for compensation to the number of students enrolled in any circumstance introduces an incentive for recruiters to actively ignore the student interest in the transition to postsecondary education, and invites complications similar to those that preceded the enactment of the ban on incentive compensation under the 1992 Higher Education Act reauthorization.
- 2. It wards off the ensuing problems.** The presence of high-pressure sales tactics in recruiting and admission could lead to increased dropout, decreased certificate/degree completion, and ultimately increased defaults on student loans. By proposing to eliminate the 90/10 and 50 percent rules, and having already eliminated the “front-end” protection banning incentive-based compensation, Congress is setting itself up for a return to the 1980s, where high-pressure sales tactics attract poorly matched students to substandard educational programs, potentially entirely at taxpayers’ expense. Combined with the incentive to boost enrollments, the motivation for “serving” students is tainted.

2007 Outlook

Congress has failed to reauthorize the Higher Education Act for the third year in a row. The 90/10 rule and 50% rule were eliminated through riders to unrelated legislation. While the ban on incentive compensation is technically still in place, regulations attached to the current authorization render the

ban nearly meaningless. A new rulemaking process to revise HEA regulations began in December 2006. NACAC submitted written testimony which included recommendations on incentive compensation on November 9. The current extension of HEA authorization expires in June 2007. Since news reports on possible violations of the ban continue, reinforcing the ban through legislative or regulatory means may be a possibility in 2007.

Warning Signs

Recent evidence suggests widespread disregard for Congressional oversight of the integrity of student aid programs, putting students and taxpayers at risk. In a time of tight budgets, safeguarding the integrity of student aid funds should be the top priority for Congress to ensure the most efficient and effective use of taxpayer funds for student aid.

Federal Investigations

- Corinthian Colleges ordered to repay \$776,241 to the Department of Education for violations of student aid procedures at Bryman College (CA). (*Chronicle of Higher Education*, 5/16/2005)
- The University of Phoenix paid \$9.8 million to settle an investigation by the Department of Education into recruiting practices that violate the ban on “commissioned sales” of admissions. The Department found that Phoenix “bases [recruiters’] salaries solely on the number of students they enroll.” (U.S. Department of Education, Program Review Report, PRCN 200340922254, 2004)
- The U.S. Department of Education’s OIG found that seven institutions, working with the Apollo Group’s Institute for Professional Development, violated the Higher Education Act ban on “commissioned sales” of admissions from 1999-2001, resulting in the OIG’s recommendation that more than \$70 million in federal funds be returned. (OIG Semiannual Reports to Congress, 2002-2003)
- The National Consumer Law Center found that in 2003, the Department of Education’s Office of Inspector General (OIG) made public seven audits documenting serious fraud and abuse in school administration of federal student aid programs. In decisions that required the return of more than \$18 million in federal student aid, the Department found widespread evidence of the following: (1) schools closing without warning; (2) Routine fabrication of financial aid documents; (3) Falsification of ability-to-benefit tests; (4) Failure to comply with the 90/10 rule; (5) Overstating program length; (6) Disbursement of funds to ineligible students
- The U.S. Department of Justice announced an investigation into allegations that the Career Education Corporation submitted false statements to the Department of Education in a previous DOE investigation. The DOJ wants information regarding “compensation for admissions personnel, the use of Pell Grant funds at one school, and student refund calculations at another.” (Yahoo! Finance News, 6/1/2006)
- The Securities and Exchange Commission launched an informal inquiry into stock-option granting practices at Corinthian Colleges, Inc., the company announced. (Yahoo! Finance News, 8/18/06)
- Apollo Group, Inc. was notified in June 2006 that the Securities and Exchange Commission was conducting an informal investigation relating to the company’s stock option grants. (APOL Form NT 10-Q, Filed July 10, 2006, p. 2)

State Investigations

- The Washington State Higher Education Coordinating Board required the Business Career Training Institute (BCTI) to repay \$63,000 in state need grants for low-income students after the school admitted falsifying enrollment tests to admit unqualified students. The Accrediting Council for Continuing Education and Training revoked the Business Career Training Institute's accreditation on March 15, 2005. In April 2005, the Council barred two BCTI presidents, Tom Jonez and Morrie Pigott, from ever again operating a school accredited by that council. BCTI had closed just days before, on March 11, 2005, after years of allegations of non-compliance with federal education and auditing regulations and several student lawsuits. (*Portland Oregonian*, 3/15/2005)
- The California attorney general's office examining allegations of fraud against a number of for-profit institutions, including ITT and Corinthian. (*Chronicle of Higher Education*, 10/1/2004)
- The Oregon Department of Education placed the Business Career Training Institute (BCTI) on probation after it found that the school was "unfair and deceptive" in how it recruited, admitted, and enrolled students. (*Portland Oregonian*, 2/5/2005) The state found that recruiters were paid on the basis of the number of students enrolled, which is a violation of the Higher Education Act. (OAR-581-045-0061, "Private Career School Agents, February 2005, Oregon Department of Education) BCTI subsequently suspended classes with no warning to students or state administrators. (*Portland Oregonian*, 3/15/2005)
- The Pennsylvania Attorney General's office has begun an investigation of Lehigh Valley College, owned by Career Education Corporation, into business practices of the school. Practices under investigation include recruitment activities, student complaints, and financial aid policies and procedures. (CECO SEC Form 10-Q, Filed August 1, 2005, p. 20)
- The New Jersey Department of Labor and Workforce Development issued a letter to the Sanford Brown Institute-Iselin, owned by Career Education Corporation, expressing concerns regarding allegations against SBI-Iselin raised in the January 2005 CBS News 60 Minutes report on for-profit colleges. DLWD requested that the school provide justification for continued operation of the school in light of the allegations raised in the report. SBI-Iselin submitted a written explanation in July 2005, and school administration met with DLWD officials in September 2005. At this meeting, SBI-Iselin received confirmation that it could continue with the submission of its license application, a process which had been delayed by DLWD. (CECO SEC Form 10-Q, Filed November 2, 2005, p. 20)
- In January 2003, the New York State Comptroller's Office began an audit of DeVry New York's compliance with the New York State Tuition Assistance Program Grant ("TAP") requirements for the three year period ending June 2002. Fieldwork was completed in June 2003 and a preliminary report was issued in July 2003. The Company responded to the preliminary report, disagreeing with some of the findings in the report. Subsequently, the Company received an amended report and responded again. In the first quarter of fiscal 2005, the Company received the final report and determination of disallowance that resulted in financial liability to the Company. The final liability was in an amount for which the Company had previously accrued. The Company has remitted the required claim of disallowance and the matter is now closed. (DeVry, Inc., SEC Form 10-Q, Filed May 11, 2005, p. 35)

- The Florida Attorney General's Office widened its investigation of Florida Metropolitan University in June 2006, seeking school records involving job-placement rates, grading, instructor qualifications, financial aid and course prices. The AG Office had announced in November 2005 that it was investigating FMU, owned by Corinthian Colleges, over the company's "advertising and marketing practices." At that time, the Florida AG subpoenaed documents from the last five years related to advertisements, training of FMU admissions officers, complaints, compensation and identity of admission representatives, and other documents. (*Tampa Bay Business Journal*, November 22, 2005; *Wall Street Journal Online*, June 22, 2006)
- Kentucky's Attorney General has asked a court to strip Decker College, a for-profit institution, of its charter, thus prohibiting it from doing business in Kentucky. Investigations by Kentucky officials revealed widespread fraud and abuse, forcing the institution to close temporarily. The investigation and court procedures in this case are ongoing. (*Louisville Courier-Journal*, November 5, 2005)
- In New York, investigations into for-profit college activities lead to a moratorium on the establishment of new programs by for-profit colleges while policymakers examined ways in which rules protect against fraud and abuse. The New York State Board of Regents has approved new regulations on for-profit institutions, including a transition period before new for-profit colleges are authorized to award degrees and a requirement that institutions enact stronger and more transparent admissions policies. (*Inside Higher Education*, May 24, 2006)
- In June 2006, California legislators considered a bill that would require for-profit institutions to report graduation and job-placement rates to the state. This bill was introduced after activists argued that weak reporting rules give for-profit colleges an open door for false advertising practices. The reporting bill, however, was amended so that it will merely establish a working group on the issue. This legislation follows an earlier law, the Private Postsecondary and Educational Reform Act, that required non-Western Association of Schools and Colleges accredited institutions to report program data to the California Bureau for Private Postsecondary and Vocational Education. A law passed in 2003, however, weakened that act by exempting regionally accredited institutions. (*Inside Higher Education*, June 22, 2006)
- The New York State Education Department ordered Taylor Business Institute, a commercial two-year business college, to close as of January 2007. The school was highly criticized for its poor curriculum, absence of leadership, high staff turnover, and high attrition rate of 80 percent. The Department also mentioned that more than 90 percent of students at Taylor had never received a high school degree.

Media Reports

- CBS News reported that recruiters for Career Education Corporation's (CEC) Brooks College employed high pressure sales tactics, and were expected to meet quotas of enrolled students. At other CEC campuses, reporters revealed that recruiters admitted clearly unqualified students, presumably to meet sales quotas. (*60 Minutes*, 1/30/2005)
- *60 Minutes'* report resulted in a hearing of the House Education & Workforce Committee on March 1, 2005, during which evidence of continued improprieties were provided by a former admission officer at one of Career Education Corporation's campuses.

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- In Oregon, former employees of American InterContinental University Online (owned by Career Education Corporation) described the institutions “admission” tactics as little more than “high pressure sales,” as recruiters were dogged by supervisors with constantly escalating enrollment targets, misleading sales scripts, and the belief that managers wanted enrollees regardless of their ability to pay tuition. (*Portland Oregonian*, 2/20/2005)
- Lehigh Valley College, owned by Career Education Corporation, is reported to have practiced illegal recruiting, enrollment, and grade reporting in Pennsylvania. Five complaints were submitted to the Pennsylvania Department of Education, which did not act on the complaints as they were “out of its purview.” (*Allentown Morning Call*, 4/25/2005)
- The Apollo Group announced plans to hire an outside agency to review its stock option practices after a Lehman Brothers brokerage report questioned whether the for-profit educational corporation had backdated past options grants. The company stated that it had already conducted a self-review and deemed its practices to be compliant with the law, but that it would hire an outside firm to “review and confirm these conclusions.” (*Wall Street Journal Online*, 6/10/2006)
 - The SEC has announced plans to strengthen and amend its executive pay disclosure requirements to explicitly address the issue of options backdating (*Wall Street Journal Online*, 6/14/2006).
 - The Apollo Group was one of many companies that issued suspect stock-options grants to top executives amidst the weakened market and low stock prices in the immediate wake of September 11 (*Wall Street Journal Online*, 7/15/06).
 - The Apollo Group disclosed that it had received a Nasdaq non-compliance notice during the week of July 10, 2006. The day after the announcement, Apollo shares declined (Yahoo! Finance News, 7/14/06).
- New York attorney general Elliot Spitzer returned a \$2000 contribution made to his gubernatorial campaign from John Sperling, founder of Apollo Group.
- Apollo Group Inc. admitted in early November 2006 to “deficiencies” in its options-granting practices, including what it termed “inaccurate documentation” of grant dates. It also said that its chief financial officer had resigned and its chief accounting officer had been placed on leave. (Yahoo! Finance News, 11/4/06)
- Corinthian Colleges Inc. stated that an independent review by a panel of attorneys has discovered that employees were issued backdated stock options grants on four occasions in 2001 and 2002. One of these grants was dated soon after the September 11 attacks, conferring additional profit potential because of the low prices following the attacks. (*Wall Street Journal*, 11/24/06)

Lawsuits

- A group of students have filed suit against the ECPI College of Technology in Greenville, SC, alleging that the school is a “fraud and a sham,” and alleging that training at the school is “severely deficient.” (*Greenville News*, August 11, 2005)

- Institutions owned by Corinthian Colleges and Career Education Corporation face lawsuits across the country from current and former students. Lawsuits present allegations of “systemic deceptive trade practices,” including: (1) Falsification of grades to maintain enrollment; (2) Misleading information about transferability of credit; (3) Illegal recruiting and compensation practices (*Chronicle of Higher Education*, 10/1/2004; *Miami Herald*, 3/11/2005; *Tacoma News-Tribune*, 4/12/2005)
- Former students of the Sanford-Brown Institute in Landover, Maryland issued a complaint in March 2006 alleging that SBI broke the MD consumer fraud act by “misrepresenting or failing to disclose, among other things, details regarding instructors’ experience or preparedness, availability of clinical
- Shareholders of ITT and Career Education Corporation are attempting to file class action suits against the companies for allegedly using misleading financial information to artificially inflate the value of their stock. (*Chronicle of Higher Education*, 10/1/2004)
- A wrongful termination suit by a former professor and “educator of the year” at American InterContinental University (AICU) against Career Education Corporation in Los Angeles indicates that fraudulent enrollment practices enabled that institution to receive federal student aid funds. According to the lawsuit, AICU enrolled clearly unqualified students, enrolled “imaginary” students, falsely advertised job placement rates, and falsified reports to sustain enrollments. (*New York Times*, 5/15/2005)
- In January 2002, a graduate of one of DeVry University’s Los Angeles-area campuses filed a class-action complaint on behalf of all students enrolled in the post-baccalaureate degree program in Information Technology. The suit alleges that the program offered by DeVry did not conform to the program as it was presented in the advertising and other marketing materials. In March 2003, the complaint was dismissed by the court with limited right to amend and re-file. The complaint was subsequently amended and re-filed. During the first quarter of the Company’s fiscal year 2004, a new complaint was filed by another plaintiff with the same general allegations and by the same plaintiffs attorneys. Discovery continues but there is no determinable date at which this matter may be brought to conclusion. (DeVry, Inc., SEC Form 10-Q, Filed May 11, 2005, p. 25)
- In November 2000, three graduates of one of DeVry University’s Chicago-area campuses filed a class-action complaint that alleges DeVry graduates do not have appropriate skills for employability in the computer information systems field. The complaint was subsequently dismissed by the court, but was amended and re-filed, this time including a then current student from a second Chicago-area campus. Discovery continues but there is no determinable date at which this matter may be brought to conclusion. The Company has accrued \$0.5 million representing the estimated minimum amount to resolve the two class-action claims. (DeVry, Inc., SEC Form 10-Q, Filed May 11, 2005, p. 25)
- On July 21, 2006, a class-action securities fraud complaint was filed in Federal District Court in the Southern District of New York against EVCI Career Colleges Holding Corporation, parent of Interboro Institute. The complaint alleged that the company had cheated in determining whether student were eligible for federal and state financial aid and had fired employees for failing to meet enrollment quotas. The complaint indicated that unethical practices at the corporation went even further than those outlined in a 2005 NY State Education Department investigation. (*New York Times*, July 24, 2006)

- *The Seattle Times* reported in early August 2006 that Crown College of Tacoma would pay over \$87,000 to settle claims by six students who alleged the school misled them about whether their credits would transfer to other colleges or universities. The settlement involved the third such lawsuit against the school. In January 2006, Crown College was ordered to pay almost \$77,000 in a case that involved a student who said the college had told her she could transfer her credits to Gonzaga University. (*Seattle Times*, August 5, 2006)
- On September 6, 2006, the Ninth U.S. Circuit Court of Appeals reinstated a lawsuit against the University of Phoenix that alleges the institution obtained federal funds under false pretenses by paying recruiters on the basis of how many students they enrolled. The case, brought against the University of Phoenix by two former recruiters, was dismissed by a U.S. District Court in California in 2004. (*Chronicle of Higher Education* and *Inside Higher Education*, September 6, 2006)
- The University of Phoenix has been sued by the Equal Employment Opportunity Commission for employment discrimination. The EEOC charged the University of Phoenix preferred hiring admission counselors who belonged to the Church of Jesus Christ of Latter-day Saints over those who did not. The suit was filed on behalf of four current or former non-Mormon University of Phoenix enrollment officers. It alleges that after these four men complained internally, the University of Phoenix transferred all of them and terminated one of them. The suit was filed as a class action.
- A class action lawsuit has been filed by Kahn Gauthier Swick, LLC in the United States District Court for the District of Arizona on behalf of shareholders who acquired Apollo Group stock and securities between November 28, 2001 and October 18, 2006. The suit charges violations of federal securities laws, including backdating of stock options.

Other

- Career Education Corporation's American InterContinental University was recently placed on a one-year probation by its accrediting agency, the Southern Association of Colleges and Schools. If AIU's accreditation is withdrawn, students attending would no longer be able to receive federal financial aid. The latest action has prompted shareholders to again question the commitment to regulatory compliance on the part of the company's governing board. (*Wall Street Journal*, December 12, 2005)
- For-profit college activities in Canada have recently prompted the Canadian legislature to consider legislation tightening rules for private career colleges. Complaints have been submitted by students from across Canada against institutions such as CDI College, owned by Corinthian Colleges. (Canadian Press (via Canada.com), November 5, 2005)