

ED Revisits Third-Party Servicer and Incentive Compensation Guidance

February 22, 2023

On February 28, [ED delayed the implementation for the new third-party servicer guidance](#) until September 1, 2023, and extended the comment period through March 28.

On February 15, ED [announced](#) two separate initiatives (one final and one proposed) that impact service providers to institutions of higher education that participate in federal financial aid programs. Both initiatives are aimed at expanding ED's oversight over third-party providers that collaborate with institutions to recruit students, develop instructional content and provide retention and other support services.

These initiatives will require institutions and their partners to carefully evaluate their existing arrangements, including assessing whether any services provided by a third party are newly subject to ED's expanded third-party servicer guidance and monitoring whether the payment structure between the institution and provider needs modification. Both announcements include opportunities for the public to share feedback and ED is actively encouraging parties to provide comments.

Expanded Third-Party Servicer Functions

ED [revised its Dear Colleague Letter \(DCL\) guidance](#) related to its "third-party servicer" (TPS) regulations, which expands the types of service providers covered by the rules and gives the agency increased oversight over third parties that contract with institutions. Although ED indicates that this DCL is effective immediately, ED is accepting public comments through March 17.

New "Servicer" Functions

Under longstanding ED rules, a TPS is an entity that enters into a contract with an institution to administer "any aspect" of the institution's participation in the federal student aid programs. A TPS is jointly and severally liable with the institution for violations of the federal student aid rules by the TPS, must be reported by the partner institution on its Eligibility and Certification and Approval Report, and must include certain provisions in its institutional partner contracts. Although ED regulations have long identified a list of certain functions that do or do not create a TPS relationship, ED has taken a very expansive view of these rules in recent years through several iterations of guidance.

Although much of the new DCL is consistent with ED's previous guidance on TPS issues, it notably adds, among other updates: (1) student recruiting services, (2) student retention services, (3) involvement in the development of instructional course content, and (4) the dissemination of marketing materials, in some cases, to the list of functions that constitute TPS functions. This is expected to greatly expand the number of third-party providers covered by ED's TPS rules.

The key additions to the list of functions that constitute TPS activities are:

1. Student Recruitment and Application-Related Activities:

- Interacting with prospective students for recruitment or securing enrollment (e.g., providing information on educational programs, application requirements, deadline, and enrollment process);
- Assisting students with completing admissions application or otherwise providing admissions and enrollment counseling;
- Processing admissions applications; or
- Establishing or modifying admissions standards for acceptance into the institution or its programs.

2. Retention Activities:

- Monitoring academic engagement and/or daily attendance.

- Conducting outreach to students regarding attendance or academic engagement.
- Responding to inquiries from students and/or their families regarding assistance or resources designed to help students maintain enrollment in the institution/program or maintain eligibility for Title IV aid.

3. Instructional Content:

- Providing any percentage of a Title IV-eligible program at an institution;
- Establishing completion requirements of a course;
- Evaluating whether students met the completion requirements of a course;
- Delivering instruction or mandatory tutoring;
- Assessing student learning; or
- Developing curricula or course materials.

4. Marketing Materials:

- Preparing or disseminating promotional materials to market educational programs, only if the provider is also involved in the design or delivery of the program or provides technology, curriculum, or faculty.

These additions are likely to encompass a significant number of companies that work with institutions to develop content and market to and recruit students, most of which were not previously covered by the TPS rules.

Other functions outlined in the new DCL – such as awarding, processing, or disbursing federal student aid, performing student eligibility activities, preparing certain consumer disclosures, performing default prevention services, providing computer or software services when the provider uses or controls systems used for financial aid, or monitoring attendance or academic engagement for Title IV purposes – were generally already covered by ED's previous guidance, even though there's been considerable ambiguity around how to interpret several of them for years. ED has generally not provided additional clarity on these here, but they continue to constitute TPS functions.

Servicer Qualifications

Institutions can only contract with a TPS that meets certain requirements. This means each institution must appropriately diligence any TPS with which it contracts to ensure it is qualified, and any TPS must be able to satisfy these requirements to do business in the space.

An institution is prohibited from contracting with a TPS that (1) was limited, suspended, or terminated by ED in the last 5 years; (2) has been convicted or, or pled nolo contendere or guilty to, a crime involving the acquisition or use of government funds; (3) has been administratively or judicially determined to have committed fraud or other material violation of law involving government funds; (4) has had to repay more than 5% of the Title IV funds it administered in either of its two most recent audits; (5) has been cited for failing to timely submit compliance audit reports in the previous five years; or (6) was either debarred or suspended or whose principals were either debarred or suspended.

The DCL also expressly states that companies that are considered a TPS, as well as their subcontractors, cannot be (1) located outside of the United States or (2) owned or operated by an individual who is not a U.S. citizen or national or a lawful U.S. permanent resident. This is not a new statement from ED but, because the definition of TPS was largely limited to active processing of Title IV funds in the past, it aligned with certain other government-wide limitations on the processing of taxpayer funds and information by overseas entities. However, ED's significant expansion into activities that are unrelated to handling funds raises concerns about the rationale for such a restriction and how it will work in practice, and ED does not explain either in its DCL. In addition, the institutions that service providers support do not have this limitation. This sudden change will create additional urgency for ED to define what it means to be "owned or operated" by a non-US owner and explain why such organizations should be excluded from supporting institutions, particularly when they are now subject to increased ED oversight.

Obligations of Servicers

An entity that is considered a TPS is jointly and severally liable with the institution for violations of the federal student aid rules by the TPS. A TPS must also undergo an annual compliance audit performed by an independent auditor and in accordance with ED's [Audit Guide](#), which must be submitted to ED. Such an obligation will be particularly challenging considering ED has very few regulations that will apply to the greatly expanded scope of covered services. A TPS must also submit an [annual data form](#) to ED describing its ownership, the institutions with which it works, and the services it provides.

Contracts with TPS providers must also include certain provisions, including obligating the TPS provider to comply with all Title IV regulations and certain data security requirements, including FERPA and FTC obligations. A provider that is newly covered by the TPS rules following this announcement may need to modify or amend its institutional contracts to include these required provisions.

Reporting and Deadlines

Institutions must report to ED any TPS contracts within 10 days of entering into or substantially modifying the contract. Following this new DCL announcement, however, institutions have until May 1, 2023, to report any TPS arrangements that were not previously reported. New providers in the TPS category also have until May 1 to file their annual data form.

Incentive Compensation Listening Sessions

ED will hold two “[listening sessions](#)” to receive public comments and recommendations to improve guidance on ED’s incentive compensation prohibition. These are largely targeted at the “Bundled Services Exception” and the role of often misnamed online program managers (OPMs) in providing services to institutions.

The ban on incentive compensation prohibits institutions of higher education from providing any commission, bonus, or other incentive payment based, directly or indirectly, on success in securing enrollments or financial aid to any persons engaged in student recruiting, admissions activities, or making decisions about the award of student financial aid.

There are several longstanding exceptions to this ban, which ED stated in a [2011 Dear Colleague Letter](#) (the “2011 DCL”). Among them, ED indicated that – although sharing a percentage of tuition revenue with a third party for student recruitment would typically be prohibited as an improper incentive payment – such an arrangement would not violate the incentive compensation ban if the tuition share is paid for a variety of bundled services (even if student recruitment is one of the services in the bundle), and the third party is unaffiliated with the institution. This is known as the “Bundled Services Exception,” and has provided the basis on which many institutions modeled payment for third parties over the last decade. In practice, this means that many institutions pay their third-party providers a percentage of program or institutional revenue for a bundle of services, rather than paying a fee-for-service for the specific services provided.

The announcement indicates that ED is considering eliminating the Bundled Services Exception, and potentially further modifying the way ED oversees third-party providers that partner with institutions. ED is specifically seeking comment on the benefits and disadvantages of the Bundled Services Exception and how changing from a revenue-sharing model to fee-for-service model would impact performance and payments under third-party contracts. It is also seeking general comments on how institutions work with OPMs and the outcomes of those relationships. This is unlikely to prevent partnerships between institutions and third parties, but may change how institutions compensate third parties that are involved in student recruiting, admissions, or financial aid.

Procedurally, it is unclear what steps ED will take to rescind the Bundled Services Exception if it decides to eliminate the option. The original parameters exist in the form of agency guidance only, through the 2011 DCL, but they reflect longstanding guidance that ED has enforced and on which institutions and third-party providers have relied for over a decade. ED appears to be foregoing a formal negotiated rulemaking – which is typically required for any ED regulations related to the federal student aid programs and was widely anticipated to occur later this year – to make this change and is instead relying on “listening sessions” to receive public comment. It is unclear what ED will do, or is required to do, with any comments it receives.

The sessions will be held virtually on March 8 and March 9, both from 1 to 4 PM ET. In addition, the Department of Education will accept written comments on the topics until March 16. ED provides a list of specific questions on which it is seeking comments in the February 15 Federal Register announcement. Individuals who wish to speak at the sessions can register via email to margo.schroeder@ed.gov.

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We are continuing to monitor these developments and would be glad to discuss how they impact your company or institution.

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