

## A Review of Income Share Agreements to Pay for College August 12, 2019

### Introduction

On June 14, 2019, a newly formed Finance Committee of the Council on Postsecondary Education held its first meeting. At that meeting, the committee chair charged staff to conduct a review of Income Share Agreements (ISAs) to determine their usefulness as a means to help students finance college costs. The chair asked staff to produce a white paper on the subject of at least five pages in length, excluding any charts, graphs, or appendices. The method used to produce this report was a review of recent research, state and federal legislation, feasibility studies, opinion pieces, and news reports regarding use of ISAs to pay for college.

In general terms, an ISA is a contract between a student and an institution, in which the student agrees to pay a portion of their income for a set number of years in exchange for the institution providing up-front funding or waiving all or part of the student's tuition (Lederman, 2017). ISAs differ from loans in how the amount owed is calculated. With a loan, students make payments based on an interest rate until their principal balance is reduced to zero. With an ISA, students pay a percent of their income for a specified period of time, regardless of the total amount paid. There is no outstanding balance and there are no fixed principal and interest payments (Horne & DeSorrento, 2017).

Students will ultimately end up paying back more or less than amounts they receive, depending on the economic benefit of their respective credentials. There are no ballooning balances due to penalty and interest charges and minimal possibility that monthly payments will exceed a student's ability to pay (Illinois Student Assistance Commission, 2014). ISA contracts are legally binding documents that specify terms and conditions of the arrangement, such as income share rates, payment terms, grace periods, minimum income thresholds, and payment caps (Friedman, 2019; Horne & DeSorrento, 2017). See Appendix A for a *Glossary of Terms for Income Share Agreements*.

### Background

The concept of financing public higher education with equity instruments is not new. It was first proposed by Milton Friedman in his essay *The Role of Government in Education* (Friedman, 1955). In his essay, Friedman describes a market failure in the financing of higher education. Specifically, unlike a loan to finance a physical asset, such as a home mortgage, a loan to finance human capital, such as education debt, provides the lender with no physical asset pledged as collateral. The relatively high risks associated with lack of security for the lender, combined with wide variation in the fortunes of individual students, would require the market to charge usurious interest rates on education loans despite high returns to schooling, leading to widespread underinvestment in higher education (Bair & Cooper, 2019).

Friedman looked to equity markets for a solution, since equity investment plus limited liability on the part of shareholders was the mechanism used to address the problem for other risky investments. Specifically, Friedman (1955) hypothesized that:

The counterpart for education would be to "buy" a share in an individual's earning prospects... to advance him the funds needed to finance his training on condition

that he agree to pay the lender a specified fraction of his future earnings. In this way, a lender would get back more than his initial investment from relatively successful individuals, which would compensate for the failure to recoup his original investment from the unsuccessful (p 10).

For more than 50 years following publication of Friedman’s essay, there was little apparent interest among state officials or postsecondary education providers in using income share approaches to finance college costs. One notable exception during that period was a Tuition Postponement Option (TPO) implemented at Yale University in the 1970s, which allowed groups of undergraduate students to borrow from the university and repay amounts received as a “cohort” by committing shares of their future incomes (Ladine, 2001). Despite noble intentions, the TPO program failed dramatically more than 20 years later, after some participants defaulted and others paid large sums to exit their agreements early, leaving those who remained paying substantially more than anticipated (Paterson, 2019). Since 2012, a growing number of states, bachelor’s degree granting institutions, a public workforce development board, and accelerated training providers have begun showing interest in ISAs.

**Oregon “Pay It Forward” program.** In December 2012, a group of Portland State University students, who were enrolled in a senior Capstone Course on Student Debt, held a Legislative Panel to present their final report, which concluded that the state of Oregon should create a *Pay Forward, Pay Back* fund. Their report received serious consideration from the 77<sup>th</sup> Oregon Legislative Assembly in the form of HB 2838, which was later amended into HB 3472 (Hammond, 2013; Oregon Legislative Assembly, HB 3472, 2013). The idea behind the *Pay Forward, Pay Back* fund was that instead of charging students tuition to go to universities, the state would fund their education and students would repay the state a percent of their income after graduation. For example, students who earned a bachelor’s degree under the proposed program would pay 3% of their annual income for 20 years (Studebaker, 2013).

Despite exaggerated national news reports that Oregon’s Legislature was moving forward with the plan (Hammond, 2013), in reality, the Assembly voted to have the Higher Education Coordinating Commission (HECC) consider creation of a proposed pilot program, which would:

- (a) Replace the current system of charging students tuition and fees for enrollment at public institutions of higher education; and
- (b) Identify one or more public institutions of higher education to participate in the pilot program.

After completing its review, if the Commission determined that a pilot program was warranted, it would submit a proposed program to the 2015 regular session of the Legislative Assembly for approval. The *Pay Forward, Pay Back* bill, HB 3472, passed unanimously during the 2013 legislative session (Oregon Legislative Assembly, HB 3472, 2013).

In response to HB 3472, a workgroup was formed and directed to develop a detailed plan for a pilot program that could be implemented during the 2015-17 biennium and that included a budget, which identified sources of funding and administration costs for the plan (Pay It Forward Workgroup, 2014). The *Pay It Forward* Workgroup, as the group would come to be called, developed a plan, which called for an initial cohort of 1,000 FTE students, selected randomly from those who applied, to be included in the pilot in 2016-17. The number of

participants was projected to grow by 1,000 FTE each year, reaching a maximum of 4,000 FTE by the fourth year. The cost of the program was estimated to be \$6.5 million in the first year, an amount that increased each year, peaking at an annual cost of just over \$20 million in the fourth year. After year four, costs would decline each year until the 22<sup>nd</sup> year, at which time the trust fund would break even and achieve self-sufficiency (Pay It Forward Workgroup, 2014, p. 11). Finally, the plan called for the state’s Office of Student Access and Completion to administer the program.

In September 2014, the workgroup’s report was submitted to the HECC, which approved the plan with stipulations, but also advised that expanded funding for need-based student aid and for campus operations were higher priorities for limited state resources than the *Pay It Forward* pilot project. In the end, the HECC did not recommend implementation of the pilot program to the Oregon Legislative Assembly, because of the estimated peak cost of \$20 million and competing priorities for state funding (Illinois Student Assistance Commission, 2014).

After news reports of Oregon’s interest in a *Pay It Forward* approach surfaced, over the next two years, similar legislation was introduced in at least 24 states. More research is needed to determine the specific form that legislation took, but analysts found that the approaches varied considerably across states and no program, pilot or otherwise, had been implemented as of November 2014 (Illinois Student Assistance Commission, 2014).

**Bachelor’s degree granting institutions.** Other education providers that have begun to show interest in ISAs are bachelor’s degree granting colleges and universities. As of May 2019, eight institutions that offer bachelor’s degrees have implemented ISA programs, including Purdue University, Lackawanna College, Clarkson University, Messiah College, University of Utah, Make School, Norwich University, and Colorado Mountain College (Pentis, 2019). Purdue University and the University of Utah are public institutions, Make School is proprietary, and the other five are private institutions.

ISAs offered by four-year colleges differ in terms of financial objectives for their programs, the scale of their programs, and contract terms and conditions. While information regarding the fiscal performance of university ISA programs is not publicly available, analysts have examined variations in program design to infer that institutions construct their ISAs with different financial objectives in mind (Bair & Cooper, 2019). For example:

[a]t Purdue, students of average incomes are estimated to pay back 1.5–1.6 times the amount received. *Back a Boiler* may thus be budget-neutral or even turn a profit for Purdue. By contrast, at Colorado Mountain College, ISA recipients never pay back more than the amount received. This means that the program, which is philanthropically funded, is a money-loser for the institution (p. 12).

Among the eight colleges and universities that have implemented ISA programs, most offer them as a supplement, not as a replacement, for subsidized student loans (Bair & Cooper, 2019). They are used to fill the gap between federal loan limits and a student’s resource needs and to provide an alternative to potentially higher cost private or Parent PLUS loans, which don’t provide income-based repayment options (Horne & DeSorrento, 2017). Clarkson University in New York and Colorado Mountain College are exceptions to this rule. The former markets their ISA program as an option for students who want to avoid taking on student loan debt, while the latter institution offers their ISA program only to students who are ineligible for

federal aid, namely Deferred Action for Childhood Arrival (DACA) recipients, who are not U.S. citizens (Bair & Cooper, 2019).

Finally, while specific contract terms and conditions vary widely among institutions that have adopted ISAs, there are commonalities across programs. For example, most programs have the same income share rates regardless of college major or amount of funding received, most have adopted payment caps to mitigate adverse selection, and many have established minimum income thresholds (Bair & Cooper, 2019). Purdue University's *Back a Boiler* program is an exception among this group, as their payback rates differ across college majors and by amount of funding received. Specifically, majors with lower expected starting salaries, such as History, English, or Social Services, have higher income share rates, while majors in the STEM fields, which often have higher starting salaries, have lower payback rates (Farrington, 2019). For a more detailed description of *ISA Contract Terms and Conditions for Selected Bachelor's Degree Granting Institutions* see Appendix B.

**Public workforce development board.** In May 2019, the San Diego Workforce Partnership, a public workforce development board, and the University of California San Diego Extension announced creation of a *Workforce ISA Fund* that will allow unemployed and underemployed individuals in San Diego County to access one of four certificate programs in high demand fields with no up-front tuition costs (Fain, 2019; San Diego Workforce Partnership, May, 2019). The *Workforce ISA Fund*, which is believed to be the first ISA nationwide initiated by a public workforce development board, will offer individuals who are traditionally underrepresented in technology fields access to 9-month and 12-month training programs in front-end web design, Java programming, business intelligence, and digital marketing (Hess, 2019; San Diego Workforce Partnership, February, 2019). These fields were identified as being among the fastest growing in San Diego County and were specifically requested by local businesses, due to a dearth of talent in those areas (Rice, 2019).

The first cohort of 100 students is scheduled to launch in July 2019, with 25 students in each of the four fields of study, and there is an expectation that number will grow to 200 students in 2020 (Fain, 2019; Rice, 2019; San Diego Workforce Partnership, May, 2019). Once students complete their credential and obtain jobs making \$40,000 or more—the minimum income threshold for the program—they will begin paying back to the fund a set percent of their income, over a specified period of time (Horn, 2019; Brandeis, 2019). Program income share rates vary between 6% and 8% and payment terms vary between 36 and 60 months, depending on a student's course of study (San Diego Workforce Partnership, FAQs, 2019).

**Coding academies.** Another place where ISAs have caught on recently is among for-profit accelerated training providers, such as coding academies, which offer students short-term training in computer programming, software development, or similar fields and places them in lucrative software engineering or web design jobs (Bair & Cooper, 2019). For example, in 2012, a "coding boot camp" called App Academy began offering a 12-week program in New York and San Francisco built around an ISA. Others like Lambda School in San Francisco, Code + Design Academy in New York, and Holberton School in San Francisco provide students similar ISA payment options (Gellman, 2018).

Most coding academies are not accredited, making them ineligible to receive federal student aid. This has compelled students to seek alternative sources of funding and contributed to growth in ISA use among accelerated training providers. In fact, it has become standard for

coding academies to offer students ISAs with little to no tuition paid up front to finance their education (Bair & Cooper, 2019). Typically, ISA contracts offered by coding academies require students to pay much higher income share rates over much shorter repayment periods, than those offered by four-year colleges. Minimum income thresholds are generally much higher in coding academy ISA contracts, as well.

## Benefits of ISA Programs

Those advocating widespread adoption of ISA programs to finance college costs identify a number of benefits that such arrangements are purported to provide. Specifically, proponents contend that ISAs: (a) expand student access to financial resources; (b) are an affordable and flexible financing option; (c) provide downside risk protection for students; (d) focus provider attention on student success; and (e) enhance program quality and efficiency.

**Expand access to resources.** Advocates argue that ISAs increase the availability of potentially lower cost resources for students to pay for education and training. Federal loans only help undergraduate students up to Stafford loan limits, leaving many students with only private loans or Parent PLUS loans above those limits, both of which are highly problematic (i.e., they are higher cost, do not provide an IBR option, and may require a co-signer). For many students, federal loans are inadequate for their financing needs. ISAs provide students access to an alternative financing tool that they can pair with federal student loans to meet their resource needs (Palacios, DeSorrento, & Kelly, 2014).

**Affordable and flexible.** A frequently cited benefit of ISA programs is that participant payments are affordable because they are based on a set percentage of earned income. Rather than having fixed principal and interest payments, ISA payments adjust up or down depending on a student's earning power (Pollack, 2019). Even skeptics acknowledge that ISAs can help students keep payments to finance education at a manageable percentage of their income (Tharp, 2019). Theoretically, if ISA's were widely adopted as a means of financing college costs, fewer people would be saddled with debt payments that exceed their ability to pay (Pollack, 2019).

Critics counter that rather than offering a solution to the escalating costs of going to college, ISAs are another avenue for students to become trapped in debt. For example, students who choose to participate in Purdue's *Back a Boiler* ISA program typically have exhausted their federal student loan eligibility. As a result, income share rates and repayment terms imbedded in the ISAs are stacked on top of existing debt obligations, which can lead to onerous payments after graduation (Morgan, Farr, & Hornung, 2019). After accounting for both federal student loan and income share commitments, monthly payments for some students could be as high as 40 percent of pretax income, posing a definitive threat to their economic security (p. 2).

**Provide downside risk protection.** One of the primary benefits of ISAs is that they reduce financial risk for students in the event their post-college incomes are lower than anticipated (Farrington, 2019). This is because students that are not employed or earn below a certain threshold typically are not required to make ISA payments (Pollack & Solomon, 2017), whereas principal and interest payments on Parent PLUS and private loans are not income dependent (i.e., they have no IBR option). Most ISAs have minimum income requirements, so someone working at minimum wage may not be required to make payments (Farrington, 2019). Students

pay more if they are successful and pay less if their educational investment does not pan out, thus providing strong downside protections for students (Palacios, DeSorrento, & Kelly, 2014). In short, the income-based repayment feature of ISAs provides program participants insurance against future income uncertainty (Peek, Guarino, Mason, & Soldner, 2017; Holt, 2016). If ISA participants do not complete, are unemployed or underemployed, or earn less than anticipated given their field of study, they could end up paying back less than the amounts received.

Although advocates claim that ISAs reduce income uncertainty risks compared to student loans, critics contend that in some cases providers can shift risks back to students by offering less favorable terms for those enrolled in less profitable majors, by requiring students to waive their rights to jury trial or class action lawsuits, and by using aggressive collection tactics if students fail to make their payments (Taylor, 2019). For example, Purdue's *Back a Boiler* program offers less favorable contract terms to students enrolled in less profitable majors, requiring them to pay a higher share of their income over the required payment term. This allows Purdue, through its ISA contract terms, to take on less risk associated with students having lower than anticipated earnings and transfer those risks back to students (Morgan, Farr, & Hornung, 2019).

**Focus attention on student success.** Another frequently cited benefit of ISAs is that they focus investor and provider attention on student success, both while participants are still in school and after they enter the job market. By design, ISAs align the economic interests of investors with those of students (Bair & Cooper, 2019). Because investors only earn a profit when a student is successful, they have a strong incentive to support students both while in school and after graduation (Palacios, DeSorrento, & Kelly, 2014; Bair & Cooper, 2019). For example, at the University of San Diego Extension, ISA program participants “have access to a wraparound support system designed to help them succeed in both the classroom and the job market, including career coaching and mentoring, exclusive networking events and internship and job placement services” (Horn, 2019, p. 2).

According to Clarkson University's website, faculty and staff are committed to giving students the resources they need to be successful in school and to accelerate career salary and growth opportunities. They strive to produce the most marketable and prepared employees through hands-on academics, high impact experiences, and an exceptional support system, that includes assistance from staff in the Career Center, Student Success Center and other campus offices, and that support continues after graduation (Clarkson University, 2019). Many coding academies provide a wide array of academic support and job placement services to help students succeed in the classroom and to find work when the graduate, such as assisting with cover letters and staging mock job interviews (Bair & Cooper, 2019). As the above examples demonstrate, sharing the risks of a student's college and career success (a.k.a., having skin in the game) can be a powerful motivator for ISA providers (Lederman, 2017; Johnson, 2019).

**Enhance quality and efficiency.** Widespread adoption of ISAs could result in improved efficiency of postsecondary systems and higher quality programs. Because ISAs generally offer either different income share rates or different payment terms depending on college major, students are channeled to high quality, low cost programs (Palacios, DeSorrento, & Kelly, 2014). A main feature of ISA programs is that investor returns are directly linked to student success, both in terms of program completion and career outcomes. In a market economy, ISAs reward providers of effective education and training programs and penalize those who provide poor

quality programs (Pollack, 2019). For this reason, analysts conclude that economic incentives imbedded in ISA's will lead to increased efficiency and enhanced program quality.

### **Criticism of ISA Programs**

Those opposed to expanded use of income-share approaches argue that ISAs may be difficult for students and families to understand (Pollack, 2019), may use terminology that makes them sound more promising than they are (Farrington, 2019), are largely unregulated (Koenig, 2019), are potentially more costly than federal student loans (Tharp, 2019), may discriminate against protected classes of individuals (McCann & Nguyen, 2017; Warren, 2019), and may contribute to continuing erosion of state support for public higher education (Illinois Student Assistance Commission, 2014).

***Difficult to understand.*** A frequently cited criticism of ISAs is that they are complicated legal documents that may be difficult for students and families to understand. There is concern that students, already facing a complicated array of financial aid and loan products, will find it difficult to understand the terms and conditions of ISAs (Pollack, 2019). Furthermore, given minimal legal and regulatory requirements for transparency, program providers and investors may oversell ISA benefits and downplay risks, leaving students with only a vague notion of what it means to take on such contracts (McCann & Nguyen, 2017). Others argue that students may find it difficult to weigh the costs of ISA funded training programs, which are imbedded in the income share rates and payment terms of the contracts, against the value of such programs in generated future earnings (Taylor, 2019). Peek and colleagues (2017) describe the issue of ISA complexity as follows:

Compared to student loans, ISAs are new to most students and to the public. ISAs also are more complicated. Student loan borrowers are responsible for learning about their loans, but there are resources to help them do so. For example, there are consumer protections, like mandatory exit counseling for student loan borrowers. For ISA funders, no such resources are currently available (p. 7).

While it may be difficult for some to comprehend ISA terms and conditions, proponents argue that they are no less complicated or confusing than student loan agreements (Marcus, 2016). In fact, both focus group and survey research has shown that students and families are amenable to the idea of using ISAs to pay for college, especially if they are provided with information regarding how ISA and student loan costs compare. For example, using focus groups, Holt (2016) found that many students and families reacted positively to ISAs and liked the insurance they provide against lower than expected earnings. In a study of loan averse young adults, Peek and colleagues (2016) found that focus group participants viewed the flexibility and fixed payment terms of ISAs as positive features. The researchers concluded that ISAs could provide a viable alternative to student loans among individuals who have negative perceptions of debt financing, thereby removing a barrier to college going among this student population. Finally, in a nationwide survey of students and parents, Delisle (2017) found that over half of survey respondents (53 percent) preferred ISAs to student loans, when detailed information was shared with them about the costs of each option over various ranges of sample income (p. 8).

**Misleading terminology.** Critics argue that the risks associated with ISAs are largely hidden and the benefits are oversold (Morgan, Farr, & Hornung, 2019). For example, ISAs are often marketed as something other than a loan, touting that there is no principal balance and no interest payments. However, according to some analysts (Farrington, 2019), the terminology used makes ISAs sound more favorable than they are. Although many ISAs advertise that students do not have to pay interest, an ISA is basically a loan and students will usually end up paying more than the original amount borrowed. Finally, the potential for accumulating excessive repayment burdens is not always readily apparent to ISA participants (Morgan, Farr, & Hornung, 2019).

**Predatory practices.** Student advocates and higher education analysts have expressed concern about the potential for abuse among private sector ISA providers. Driven by profit motive, private providers may oversell the expected benefits and be less than fully transparent about ISA program costs. Students could be especially vulnerable to predatory practices of disingenuous ISA providers (Pollack, 2019). Others are concerned that students could find themselves locked into contracts with unfavorable terms and few consumer protections (McCann & Nguyen, 2017).

Congress could enact legislation to prohibit predatory practices and unfair terms in ISA contracts, but according to some analysts, the only bills introduced to date primarily benefit program providers and investors (Morgan, Farr, & Hornung, 2019). For example, if adopted, the *Investing in Student Success Act* would reduce risk to investors by giving ISAs favorable legal treatment on par with student loans, such as exemption from bankruptcy protections, while at the same time declaring that ISAs are not loan products, thus allowing them to avoid consumer protection and disclosure requirements. Based on their research, Morgan and her fellow researchers conclude that:

until ISA models emerge that truly balance the risk between students and funders and adhere to commonsense consumer protections, members of Congress should focus on protecting students and take caution before promoting ISAs as a central solution to the student debt crisis. Otherwise, ISAs will merely be student debt by another name (p. 2).

**Potentially more costly.** With ISAs, students could end up paying much more than they would under a traditional federal loan for the same amount borrowed and the cost to get out of an ISA contract can be even higher. Although there is no penalty for paying off a federal loan early, terms and conditions in some ISA contracts require borrowers to pay up to 2.5 times the original amount received to buy out of an income share agreement (McCann & Nguyen, 2017). There appears to be general agreement among analysts that given a choice between a federal student loan with an income-based repayment (IBR) option and financing college with an ISA, the former is the better alternative. For example, using assumptions based on Purdue's *Back-a-Boiler* ISA program, Tharp (2019) found that federal IBR loans would be less expensive for students, both in terms of total repayment costs and cash flow protection over time. The key takeaways from Tharp's analysis are provided below.

[A]lthough “equity financing” college with an ISA may seem to intuitively be a favorable alternative to student loans, the advantages don't pan out when we start looking at the total costs and the impact they have on future cash flows... the



answer to the question of when it would be better to finance a college education with “equity” in a student’s future earnings is a resounding: rarely (p. 2).

The evidence was less clear when comparing ISA program costs to Parent PLUS and private loans. Tharp’s analysis did show that for certain disciplines ISAs were the better alternative.

**Potentially discriminatory.** Opponents argue that ISAs have a problem at their core that the federal student loan program has sought to solve, namely, discrimination. Federal student loans offer the same terms to all students, regardless of race, gender, credit history, or program of study, but this is not the case with ISA agreements, where critics argue that structural discrimination is imbedded in the contract terms of many current programs (McCann & Nguyen, 2017). Not all ISA contracts offer the same terms and conditions to all students, even within the same college or university. Some offer better terms to students enrolled in programs expected to generate higher incomes (Warren, 2019) and some include past credit history as a selection criteria, which may disadvantage students of color (McCann & Nguyen, 2017).

Students of color often take on more debt to pay for college, but often realize lower economic returns from comparable levels of education due to discrimination in labor markets (Warren, 2019). People of color and women are both more likely to enroll in fields of study that lead to lower paying jobs and are more likely to earn less than their white male peers in comparable jobs (McCann & Nguyen, 2017). These realities suggest that ISAs will inherently have a discriminatory impact on students of color and women, both in terms of students' reliance on them and difficulty paying their monthly obligations (Warren, 2019). Others are concerned about applicability of ISAs at some institutions and in some disciplines (Schwartz, 2019).

A major issue that has not yet been resolved is whether or not ISAs are credit products and the related legal treatment of ISAs. Some contend that the eligibility criteria and pricing of ISAs raise serious questions about whether they comply with ECOA and other federal laws that prohibit discrimination on the basis of certain protected classes like race, sex, or age (Warren, 2019). Program providers and investors portray ISAs as something other than a loan for both marketing and legal reasons. If ISAs are technically not credit products, then they may not be subject to the same anti-discrimination laws and regulations as student loans (Taylor, 2019). Others posit that although ISA programs can be constructed so there is no discriminatory intent, there may be disparate impact, which could lead to legal challenges (Rustin, Grayson, & DeGroote, 2017).

**Erosion of state support.** No issue is mentioned more in the literature critical of *Pay It Forward* programs than the possibility that such programs may contribute to a shifting of responsibility for college costs from taxpayers to students and families. Some in the higher education community are concerned that growth in *Pay It Forward* programs will focus policymaker attention on the private benefits of education instead of on the societal benefits and will accelerate the transition, which many believe is already underway, from a publicly funded model of higher education to a student and family funded model by reducing taxpayer subsidies to state colleges and universities. Analysts contend that, under *Pay It Forward* plans, it would be easier to obscure further erosion of the shared responsibility model for financing public higher education that all states have to some degree (Illinois Student Assistance Commission, 2014).

## Impediments to ISA Growth

Two potential impediments to ISA program expansion include absence of legal and regulatory frameworks governing the operation of such programs (Palacios, DeSorrento, & Kelly, 2014) and the fact that ISAs allow significant opportunity for students to engage in adverse selection (Bair & Cooper, 2019; Tharp, 2019).

**Largely unregulated.** The emerging use of ISAs as an alternative to Parent PLUS and private loans is a relatively recent phenomenon. As such, there is a conspicuous lack of legislation or regulation governing the operation of ISAs (Farrington, 2019) and little clarity regarding how consumer protection laws should apply to such programs (Pollack, 2019). This legal and regulatory uncertainty has made it difficult to attract investors and has prevented the market from developing on a larger scale (Peek, Guarino, Mason, & Soldner, 2017).

Analysts contend that these concerns could be mitigated if Congress would adopt strong consumer protection laws that safeguard students from potential predatory practices of ISA investors and program providers. To facilitate growth of ISAs as a new financing option, proponents recommend that Congress and other policymakers take steps to provide legal clarity for ISA contracts, place reasonable limits on federal student loans, modify federal student loans to simplify repayment processes, and remove the restriction on student unit record data (Palacios, DeSorrento, & Kelly, 2014).

Morrison and Foerster (2019) contend that ISAs should not be viewed as credit products since they do not generally contain an unconditional obligation to repay. While the courts have not applied a uniform test to distinguish between credit and non-credit transactions, the fact that ISA providers bear the risk of nonpayment and do not retain a right of recourse against participants in the event of nonpayment bolster this argument. According to the researchers, if ISAs are not credit products, they should not be subject to various existing consumer credit laws and regulations, including the federal Truth in Lending Act (TILA), the Equal Credit Opportunity Act (ECOA), and the Fair Credit Reporting Act (FCRA). To date, the courts have not considered whether or not ISAs constitute credit for the purposes of TILA, ECOA, and FCRA.

According to Rustin, Grayson, and DeGroot (2017), the risk of someone bringing an ECOA claim against an ISA investor or provider is substantial. This is because some of the best metrics used by ISA investors to assess a student's potential for future college and career success may disproportionately impact certain protected classes of people. Evidence of discriminatory intent is not necessary to establish that a policy or practice has disparate impact and may be subject to an ECOA claim. The researchers advise that ISA investors and program providers should maintain detailed and accurate records and be prepared to show that any disproportionate impacts are due to legitimate business necessity, such as differences in credit worthiness, and there are no less discriminatory alternatives for the policy or practice.

**Adverse selection.** An inherent risk in ISA programs is that they provide a significant opportunity for students to engage in adverse selection. As defined in the literature, adverse selection is a situation that occurs when students who have confidence in their abilities and future career prospects choose traditional student loans (Bair & Cooper, 2019) and students who are less confident in their outlook, or who have plans to stop out of the workforce or be underemployed, choose to finance their education with an ISA (Tharp, 2019). If prevalent, adverse selection limits potential returns for investors, because they are unable to recover

losses on students who do worse than expected in the job market from those who fare well (Bair & Cooper, 2019). According to Tharp (2019), there are no existing examples of ISA programs that have effectively managed the adverse selection problem. It represents a major obstacle that education providers must overcome for ISAs to become viable long term.

More research on the effects of adverse selection is needed. One recent study found that student selection into Purdue University's ISA program was driven by parent characteristics, salary differences across majors, and location preferences, but there was no adverse selection based on risk aversion, financial and employment experience, or student ability. The analyst posits that adverse selection in Purdue's program was less than expected because: (a) program eligibility is limited to sophomores, juniors, and seniors; and (b) income share rates differ depending on major and year in school (Mumford, 2018). Others agree that adjusting the terms of ISA contracts based on differing circumstances, most notably in response to different programs of study, is an approach that reduces the potential for adverse selection (Palacios, DeSorrento, & Kelly, 2014), as is offering lower payment caps overall. It is worth noting that adverse selection is only problematic to the extent that ISA investors expect a positive return on investment. As in the case of Colorado Mountain College, profit motive is not necessarily the driving force behind all ISA programs (Bair & Cooper, 2019).

## **Economic Feasibility**

A basic question for any accelerated training provider, postsecondary institution, or state policymaker considering an ISA approach is whether and to what extent such programs are economically viable or sustainable. A frequent answer among analysts and practitioners is that it is too soon to tell whether or not ISAs will prove to be sustainable mechanisms for financing higher education.

Most currently active programs are too new to provide a clear verdict on the potential success of ISAs and their graduates (Hess, 2019). According to Google's Andrew Dunckleman, "we are still in the very early stages of figuring out what this model is going to look like at scale...more innovation, more pilots, more practice is welcomed...it's still pretty early to understand if [ISAs are] having a meaningful impact on people's jobs and wages" (p. 4).

Purdue's president, Mitch Daniels, acknowledges that his university's program is still small and the exact financial formula needed to make it work is still to be determined. In his opinion, for ISAs to become a viable option "we need scale...we need other schools and many more students participating, so that the marketplace of potential investors sees repayment history and we all learn more about how well this works" (Cohn, 2019, p. 2).

In a comprehensive study of state level *Pay It Forward* (PIF) legislation, the Illinois Student Assistance Commission found and advised their General Assembly that, at present, states only have their own resources to invest in PIF programs (i.e., there were no federal funds available at the time) and that difficulty tracking addresses and collecting payments from program participants would result in higher per participant costs for state programs than for a nationwide program. In addition, the authors of the Commission report concluded that *Pay It Forward* programs would never be economically feasible or sustainable, as long as college costs increased faster than per capita personal incomes (Illinois Student Assistance Commission, 2014).

## Recent Developments

As previously discussed, a major impediment to growth of ISA programs has been the absence of statutory and regulatory frameworks that would provide guidance to potential investors and program providers. This has prompted policymakers at both federal and state levels to consider whether and how to regulate such agreements (Morrison & Foerster, 2019) and has resulted in political lines being drawn on either side of the issue (Paterson, 2019; Warren, 2019).

**Federal legislation.** In 2017, two bills were introduced at the federal level that, if enacted, would have provided a legal framework governing the provision and use of ISAs, including, S. 268, the *Investing in Student Success Act of 2017*, introduced by Senators Todd Young (R-Ind.) and Marco Rubio (R-Fla.) and H.R. 3145, the *Investing in Student Achievement Act of 2017*, introduced by former Representative Luke Messer (R-Ind.) and co-sponsored by ten Democrats and nine Republicans (Morrison & Foerster, 2019). Neither of these bills was acted upon before the adjournment of the 115<sup>th</sup> Congress. In 2018, Mark Green (R-TN) and Vicente Gonzalez (D-TX) introduced a bipartisan House bill, H.R. 1810, the *Kids to College Act*, which reportedly would authorize ISAs as an alternative to student loans (Morrison & Foerster, 2019). More research is needed to determine the status of this bill (see Appendix C for more information).

On July 16, 2019, Senate lawmakers Todd Young (R-Ind.), Marco Rubio (R-Fla.), Mark Warner (D-Vir.), and Chris Coons (D-Del.) introduced a bipartisan bill—SIL 19815, the *ISA Student Protection Act of 2019*—that, if enacted, would strengthen the framework and spur growth of ISAs, give the Consumer Financial Protection Bureau oversight authority of ISAs, and make ISAs dischargeable in bankruptcy (Kreighbaum, 2019). Under SIL 19815, ISA providers are prohibited from entering into agreements with students that require payments higher than 20.0 percent of income for short-term contracts or higher than 7.5 percent for long-term contracts, an individual earning less than 200 percent of the Federal Poverty Level (\$24,980 in 2019) would be exempt from making payments towards their ISA, the maximum amount of time an individual would be obligated to pay could not exceed 360 months (i.e., 30 years), and the total percentage of future income under the current and any other Qualified ISAs could not exceed 20 percent. The bill also requires providers to disclose how ISA payments would compare to federal or private loan payments for the same amount received, and it clarifies tax treatment of ISA contributions for providers and participants (U.S. Senate, SIL 19815, 2019; Warner, 2019).

**State legislation.** In recent years, several states have shown interest in ISAs, although to date no state has taken formal action in this area (Morrison & Foerster, 2019). In Washington State, there is legislation pending that, if enacted, would establish a pilot program and allow participants to enter into ISAs through 2029. In Illinois, bills were introduced in the House and Senate that, if enacted, would create the *Illinois Student Loan Investment Act*, which would provide for the establishment, operation, and administration of a newly created Student Investment Account and allow the State Treasurer to originate and service student loans and enter into ISAs with students.

In 2019, a member of the California State Assembly introduced legislation (AB 154) that, if enacted, would require California State University and the University of California to each select a campus of their respective systems to participate in a pilot program that would allow students

to enter into an ISA, commencing with the 2021-22 academic year (California State Assembly, 2019). The program, patterned after Purdue University’s ISA model, would be open to second, third, and fourth year students, who would pay an unspecified percent of their income to their respective university for 10 years (Gasparyn, 2019). Payments would begin six months after the student was no longer enrolled full-time and would not be required during periods when the student’s annual income fell below \$20,000 (California State Assembly, 2019).

**Political context.** During a recent panel discussion at the Reagan Institute Summit on Education, Diane Auer Jones, the Principal Deputy Under Secretary of Education, stated that her agency was looking for ways to provide support for ISAs. She went on to say that Department of Education officials hope to experiment with federal support for ISAs, with the caveat that such agreements must be designed carefully and may not work for every institution (Paterson, 2019).

On June 4, 2019, Senator Elizabeth Warren (D-Mass.) and two House Democrats—Ayanna Pressley (D-Mass.) and Katie Porter (D-Cal.)—sent a letter to Secretary of Education Betsy DeVos, expressing concern that the U.S. Department of Education “is exploring an experiment with Income Share Agreements (ISAs) in federal higher education programs” and seeking information to evaluate “whether these plans are in the best interest of students and within the Department’s authority under the law” (Warren, 2019, p. 1).

Although Senator Warren’s letter was prompted by talk of federal support for ISAs, the Democrats expressed concern about ISAs more broadly, arguing that they share many of the same pitfalls as traditional private student loans, with the added danger of deceptive rhetoric and marketing that obscure their true nature (Kreighbaum, 2019). Below are excerpts from Senator Warren’s letter highlighting concern about ISAs.

- The terms of ISA contracts can be predatory and dangerous for students.
- ISAs include some of the most exploitative terms in the private loan industry, including mandatory arbitration agreements and class action bans.
- Unlike private loans, these risky contracts have virtually no transparency and receive little to no oversight from federal regulators.
- Due to discrimination in labor markets, ISAs will inherently discriminate against people of color.
- Because ISAs do not offer the same terms and conditions to all students (i.e., they vary by program based on expected income), ISA eligibility criteria and pricing raises serious questions about whether they comply with ECOA and federal anti-discrimination laws.
- An ISA is simply a debt that has to be repaid. By design, ISAs often require students to pay much more to funders than they originally received.

## **Implications**

Based on a review of recent research, state and federal legislation, feasibility studies, opinion pieces, and news reports pertaining to recent experimentation with Income Share Agreements for financing postsecondary education and training, several concepts can be

identified that may assist state policymakers who may be considering whether and how to make use of this new funding mechanism.

- Before any action is taken by state agencies or public postsecondary institutions to implement ISA programs, general assemblies and governors should adopt legislation providing a legal and regulatory framework for such programs.
- Legislation directing state higher education governing or coordinating boards and agencies that administer state financial aid programs to conduct a comprehensive feasibility study of ISAs is an important first step in the process (e.g., as was done in Oregon and Illinois).
- Because the long term sustainability of ISA programs has not yet been determined, the projected cost of some exploratory ISA pilot programs has been found to be quite high, and there continues to be a dearth of statutory and regulatory guidance at the federal level, a pilot program that initially limits the scope of state funded ISA programs and provides for detailed evaluation of program results is recommended.
- Upon completion of a feasibility study, governors, legislators, higher education boards, postsecondary institutions, and other stakeholders need to determine whether, given the cost of such programs, ISA funding is the highest and best use of limited state resources (e.g., need-based aid and campus operating funds were higher priorities in Oregon).
- If governors and legislators determine that ISA funding is a high priority, then legislation defining the scope, participants, and parameters of a pilot program should be enacted.
- Postsecondary institution participation in an ISA pilot program should be voluntary and initially limited to two or three institutions statewide that have sufficient interest and resources to fund such programs (i.e., to minimize risks and control costs).
- Institutions that choose to participate in a state sponsored ISA pilot program should contribute the lion's share of funding for the project, to preserve one of the most compelling benefits of such programs, namely, creating vested interest in student success among education providers (i.e., sharing risks and aligning student and postsecondary institution interests).
- Federal grants to support state pilot programs may be necessary to facilitate growth in the number of ISA providers and would likely include matching requirements for both state and institutional investors.
- Agencies that administer state financial aid programs could serve as fiscal agents responsible for tracking addresses, verifying income levels, and collecting payments from ISA program participants, or these activities could be outsourced to a third-party vendor (e.g., such as Vemo at Purdue University and the University of Utah).
- Terms and conditions of state administered ISA programs should be structured to provide students the lowest possible income share rates and shortest possible repayment terms, while still realizing and maintaining sufficient collections to replenish the fund.

- Initially, pilot program ISAs should only be offered to students that have reached federal Stafford Loan limits, as an alternative to Parent PLUS and private loans that can be higher cost and provide less downside risk protection for students.
- In order to minimize program costs, shorten initial repayment cycles, and reduce risks for state and institutional investors, ISAs should only be offered to eligible juniors and seniors with declared majors.
- Additional details regarding pilot program campus participants, matching requirements, ISA contract terms, student eligibility requirements, collection agents and processes, and overall program costs could be determined as part of a feasibility study.
- To facilitate growth in ISA programs among states, postsecondary institutions, and accelerated training providers, Congress should adopt legislation providing a statutory and regulatory framework for such programs.

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## Appendix A

### Glossary of Terms for Income Share Agreements

- **Income** — an individual’s total earnings as reported to the Internal Revenue Service. Typically excludes non-earned income such as lottery proceeds, inheritance, and capital gains (Horne & DE Sorrento, 2017).
- **Income Share Rate** — the percentage of pre-tax income that individuals agree to pay on a monthly basis, as established at the outset of the ISA (Friedman, 2019).
- **Payment Term** — the total number of months that an individual is required to make payments, typically between three and 10 years (Horne & DeSorrento, 2017).
- **Grace Period** — period of time after leaving school in which no payments are expected, typically at least 2-3 months (Friedman, 2019).
- **Deferment (Tolling)** — period of time during which an individual is not required to pay the income share due to lack of employment, returning to school, raising a family, or some other reason. In some situations, the payment term continues to count down during deferment. In others, the payment term is paused (Horne & DeSorrento, 2017).
- **Minimum Income Threshold** — the level of income below which an individual has no payment obligation. Individuals earning above the threshold are expected to make payments according to the ISA terms (Horne & DeSorrento, 2017).
- **Payment Cap** — the maximum cumulative amount that an individual will ever have to pay, typically somewhere between the value of initial funding and 2.5 times the initial funding (Horne & DeSorrento, 2017).
- **Refunds** — depending on terms of the ISA, individuals may be entitled to refunds, which take the form of term reduction or income-share reduction (Friedman, 2019).
- **Living Stipend** — monthly stipends can be provided through an ISA to help students cover cost-of-living expenses while in school (Friedman, 2019).
- **Non-Interference** — ISAs may stipulate that program providers and investors may not influence an individual’s career, education, or life choices. Individuals promise to pay a share of their income, not to work in any particular field (Horne & DeSorrento, 2017).

## Appendix B

### ISA Contract Terms and Conditions for Selected Bachelor’s Degree Granting Institutions

#### *Purdue University (Back a Boiler Program)*

The Purdue program was designed to replace private or parent borrowing for students with a gap to fill in financing their undergraduate education (Lederman, 2017). Originally designed for juniors and seniors, the program was recently expanded to include sophomores. ISA contracts offered through the *Back a Boiler* program contain the following features:

- Students must be enrolled on a full-time basis
- U.S. citizen or permanent resident
- Rising Sophomore, Junior, or Senior with declared major
- All majors are eligible for the program
- May receive up to \$10,000 a year (maximum 15% of expected annual income)
- New ISA required for each year (income share percentages are cumulative)
- Share of income varies based on major (between 1.7% and 5.0% per \$10,000 received)
- The standard payment period is about 10 years
- Students are afforded a 6-month grace period after graduation before payments begin
- Minimum salary threshold is \$20,000
- For qualifying circumstances, payment term may be extended by one month for each month of deferral (up to 60 month maximum)
- Payment cap is 2.5 times the total ISA amount received

#### *University of Utah (Invest in U Program)*

In January 2019, the University of Utah announced an income share agreement program for students in select majors who were close to graduation (Schwartz, 2019). The program, branded “INVEST IN U”, contains the following features (UNEWS, 2019):

- Students within one year of graduating
- Enrolled in one of 18 eligible majors
- May receive \$3,000 - \$10,000 for the fall/spring
- May receive up to \$4,500 for the summer semester
- Six-month grace period following graduation
- Students pay back 2.85% of monthly net incomes
- Length of payment term varies by amount received and major
- Payment deferral if students enter graduate school, participate in voluntary service, or are employed in full-time jobs earning less than \$20,000 a year

#### *UC San Diego Extension (Workforce ISA Fund)*

In May 2019, the San Diego Workforce Partnership, a non-profit workforce development board, and the University of San Diego Extension school announced a new *Workforce ISA Fund* that will pay up front tuition costs for 100 students to take a six-month online and in-person course at

the extension campus in digital marketing, business intelligence, Java programming, or web development (Hess, 2019). It is believed that this is the first ISA initiated by a public workforce development board and it is the first such program in the UC system. The San Diego Workforce Partnership ISA program contains the following features:

- Tailored to those interested in a career in the technology industry
- Student enrolled in one of four eligible certificate programs
- Tuition costs of \$6,500 are paid up front by the San Diego Workforce Partnership
- Participants have access to mentors in their field, career services, and internships
- One-month grace period after leaving the program
- Depending on course of study, students pay back between 6% and 8% of earned income
- Length of payment term is between 36 and 60 months depending on course of study
- Payments pause if earned income drops below minimum threshold (\$40,000 annually)
- Payment cap is \$11,700 or 1.8 times the cost of the program

## Appendix C

### Selected Federal Legislation Pertaining to ISAs

#### ***S. 268 – Investing in Student Success Act of 2017***

In 2017, Senators Todd Young (R-Ind.) and Marco Rubio (R-Fla.) introduced a bill—S. 268, the *Investing in Student Success Act of 2017*—that, if enacted, would have provided a legal framework governing the provision and use of ISAs. Specifically, the bill would have authorized investors and students to enter into ISAs, under which a student agrees to pay an investor a specified percent of future income, for a specified period of time, in exchange for funds to pay for postsecondary education. Under S. 268, an ISA that complied with the terms and conditions set forth in the bill and met the bill’s disclosure requirements would have been a valid, binding, and enforceable contract (Morrison & Foerster, 2019). In addition, every ISA contract would have to include language specifying:

- the percent of future income an individual would be obligated to pay;
- that an individual would not be required to pay any portion of income for any year in which the individual had an income of less than \$15,000 (adjusted for inflation);
- that the percent of income required to be paid could not exceed a threshold annual repayment amount paid that exceeded aggregate annual principal and interest payments for a comparable loan with a fixed annual interest rate of 20 percent; and
- that no eligible individual could enter into an ISA if the total percent of future income pledged, in combination with any other ISAs, exceeded 15 percent.

Under S. 268, ISA providers would have to furnish a disclosure document to prospective participants that contained required information in clear and simple terms and a comparison of: (a) amounts an individual would be required to pay under the ISA at a range of expected annual income levels; and (b) payment amounts under a comparable loan product with a fixed annual interest rate of 10 percent (Morrison & Foerster, 2019). The bill also contained provisions related to the tax treatment of ISAs.

#### ***H.R. 3145 – Investing in Student Achievement Act of 2017***

A companion bill to S. 268, H.R. 3145, the *Investing in Student Achievement Act of 2017*, was introduced by former Representative Luke Messer (R-Ind.) and co-sponsored by ten Democrats and nine Republicans. It contained provisions similar to those in S. 268, as well as, provisions addressing treatment of ISAs under federal consumer finance laws. Like Young-Rubio (S. 268), Messer’s bill (H.R. 3145) was not acted upon before the adjournment of the 115th Congress (Morrison & Foerster, 2019).

#### ***H.R. 1810 – Kids to College Act***

Although the above pieces of legislation are no longer active, Mark Green (R-TN) and Vicente Gonzalez (D-TX) introduced a bipartisan House bill, H.R. 1810, the *Kids to College Act*, in the 116th Congress, which reportedly would authorize ISAs as an alternative to student loans (Morrison & Foerster, 2019).