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The Income Share Agreement Landscape

2017 and Beyond

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Introduction

Despite many uncertainties facing the nation regarding education policy, one issue seems likely to move forward in the coming years: increasing access to income share agreements (ISAs).

An ISA is a new form of private financial aid that offers students money upfront to pay for college in return for a percentage of students' future earnings. Currently, just one traditional postsecondary institution, Purdue University, offers an ISA through its Back a Boilermaker program. At a handful of coding boot camps and specialized institutions, all students use ISAs to cover their tuition and fees. Despite this small market, buzz about ISAs is growing on Capitol Hill and in state legislatures. Substantial shifts in the ISA landscape may be on the horizon.

American Institutes for Research (AIR) released several studies on the potential for ISAs to help low-income students pay for college. The purpose of this brief is to explore the current state of the ISA market and highlight opportunities and threats to its expansion. Based on a survey of ISA funders and interviews with ISA experts, we found:

- Today's ISA market offers two products: ISAs intended to be students' primary source of financial aid, and ISAs intended to fill in the gaps after federal aid.
- The ISA market has used several strategies for expansion: building legitimacy through partnerships with institutions, emphasizing how ISAs protect against a risky labor market, and promising that ISAs will improve the relationship between price and outcomes in higher education.
- The ISA market faces several barriers to expansion: the complexity of its products, public mistrust, and unresolved legal questions.
- Changes to the Graduate PLUS loan program may open the door to further ISA expansion.

Definitions

- Direct loan: The federal Direct loan program makes loans to undergraduate and graduate students. For some of these loans, the interest payments are subsidized while the student is still enrolled in school. Loan amounts are set by the federal government.
- PLUS loan: The federal PLUS loan programs make loans to graduate students and to parents of undergraduate students. Interest is not subsidized. Loan amounts are determined based on the cost of attendance.
- Cost of attendance: The cost of attendance is the total cost of tuition, fees, room, board, and other related expenses at a particular institution. Each institution calculates its cost of attendance individually.

Methodology

To understand the state of the current ISA market, we surveyed ISA providers about their products. We developed a list of 10 ISA providers based on a web search, media mentions, and snowball sampling. Six providers submitted answers to the survey. Information regarding average ISA terms, as well as the number of students who have received ISAs, is generally not available on ISA funders' websites. Thus, our survey cannot tell us definitively how much the ISA market has grown in recent years, nor which ISA types are likely to have the most success.

To understand the history and future of the ISA market, we conducted eight interviews with ISA experts: three researchers specializing in financial aid, three ISA funders who originate or provide ISAs, and two advocates who have many years of experience promoting ISAs. These experts' experience in the field gives them insight into trends in ISA policy and practice.

Together, the survey and interviews reveal the state and future of the ISA landscape. We present our findings as an analysis of the market's strengths, weaknesses, opportunities, and challenges, or a SWOT analysis, to highlight the strengths and weaknesses of the current ISA market and explore opportunities and threats to the market's expansion.

Today's ISA Market

The ISA market is new and still very small. It also is diverse. To make sense of the variety of ISAs in the market, we divide them by their purposes.

One type of ISA is designed to be the primary source of funding for a student. These ISAs cover up to the full tuition amount. These "primary source ISAs" are often offered at institutions, such as coding boot camps, that cannot offer federal financial aid. Primary source ISAs also may be attractive to students who do not want to borrow federal student loans for a variety of reasons, such as immigration status or loan aversion (Peek, Mason, & Soldner, 2016).

The second type of ISAs are designed to fill in the gap between a student's other financial aid and the cost of attendance. These ISAs are the "secondary source" of funding that help cover a student's need. Secondary source ISAs are more common at institutions that do have access to federal aid. They are intended to replace private loans or federal PLUS loans.

Table 1 illustrates the main differences between the primary source and secondary source ISAs that responded to our survey.

Table 1. ISA Types Based on Funding Purposes

	Primary Source ISA	Secondary Source ISA
Type	ISA could cover or substantially support costs.	ISA supplements other financial aid.
Amount	Up to full tuition amount	Range up to $30K Average $10–$15K
Payment Terms	Percentage of income and length of repayment vary widely.	Average 5%–7% of income over 7–15 years
Minimum Income Threshold	All respondents said students who earn below a certain threshold can skip or pause payments, but nearly all must extend the payment period.	

The types of students and programs that ISAs target vary widely. A majority of respondents in our study said students do not need to meet merit requirements, demonstrate financial need, or study a particular subject to qualify for an ISA, although in some cases investors or postsecondary institutions that partner with organizations will set varying eligibility terms. Although most respondents offer ISAs to students in any kind of postsecondary program, a third are singularly focused on undergraduate students or graduate students only. More than half of respondents mentioned that certain types of students will contact them with an interest in an ISA, such as first-generation students who are uncomfortable with debt.

Regardless of their target population, all respondents indicated that they were interested in providing recipients with additional academic and career supports. Most respondents said they were in the development phases of building additional resources for students who use their ISAs. Some already provide or hope to provide professional support such as career advising, mentoring, résumé and interview coaching, and networking opportunities. Others offer or wish to offer educational supports such as tutoring.

Terms varied across ISA types. Some ISAs are fixed for the length of the contract, but payment length and percentage of income could vary by postgraduation expected income, the amount financed through the ISA, or an algorithm that takes many variables into consideration. Minimum income thresholds, however, were included in all of the ISAs that responded to the survey, allowing recipients to skip payments when their income falls below a threshold. Two thirds of respondents also said they extend the repayment period if student income falls below the threshold. In those cases, recipients with low incomes could see their payment periods extended.[1]

[1] It is unclear how these extensions would work for recipients who take time out of the labor force for unpaid caregiving, such as stay-at-home parents. Given that unpaid caregiving is typically done by women, this could have a disproportionate impact on women ISA recipients.

SWOT Analysis

In interviews with ISA experts, we examined the market's strengths and weaknesses. In particular, we asked about the strategies that ISA funders and advocates use to market themselves to students and the general public. We also asked about barriers to expansion, and we tried to understand what makes ISAs successful despite these barriers. Table 2 provides an overview of our findings.

Table 2. Strengths, Weaknesses, Opportunities, and Threats to the ISA Market by Type of ISA

	Primary Source ISA	Secondary Source ISA
Strengths of ISA market		
Legitimacy strategy		X
Risk protection feature	X	X
Pricing pressure feature	X	
Weaknesses of ISA market		
Complexity of products	X	X
Mistrust of products	X	X
Legal murkiness	X	X
Opportunities for expansion		
Changes to Grad PLUS	X	X
Better marketing	X	X
Threats to expansion		
Extending federal loan access	X	
Increasing federal loan amounts		X

Strengths of the ISA Market

One way to understand the strengths of the ISA market is to examine how ISAs are sold. When we asked about strategies for marketing ISAs to students, institutions, and the general public, many ISA experts emphasized the importance of building legitimacy through partnerships with trusted entities. These comments demonstrate that the ability to build on existing relationships has been crucial for ISA funders' success. Experts also emphasized the risk protection that ISAs offer against future changes in income, indicating that economic instability has in some ways been a boon to ISAs. Finally, a few experts touched on the role that ISAs could play in keeping tuition prices low, which shows that at least some ISA funders believe that ISAs can address students' and parents' concerns about upfront costs.

Building on Existing Relationships

For primary source and secondary source ISAs, partnerships with postsecondary institutions or other trusted parties are key. Purdue University's success can be attributed in part to this strategy. According to one researcher, "The reason that there's the take-up that there was at Purdue is because this is a Purdue-branded program rather than an outside provider coming in and offering this financial product." The researcher noted that students are "wary of complex, or what they perceive as complex, financial products" like ISAs, and this can be overcome by "stamping the brand of an institution onto that product." Though the Purdue Research Foundation, a separate nonprofit entity, originates the ISA and coordinates with a loan servicing company to collect payments, students can still learn about the program through the Purdue website and contact financial aid officers for more information.

Purdue's secondary source ISA also benefits from its ability to use Purdue's financial aid infrastructure to explain ISAs to students. Students who use ISAs to fill the gap between other funding and their total cost of attendance already rely on financial aid officers to navigate the byzantine federal aid process. Because the institution offers the ISA, financial aid officers are familiar with the ISA terms and are able to help students consider this option. Institutions also are able to adjust the terms of the ISA, in partnership with the funder, to fit their students' needs.

For primary source ISAs that cannot take advantage of an institution's brand, external relationships can help build credibility. One ISA provider explained that their organization partnered with trusted advisors in target communities to present the idea as legitimate. This provider noted that students tend to be wary of "an old White guy investment banker" who asks to speak with them. Using social networks is another way to gain access to a community.

Risk Protection

A key selling point for ISAs is that they are less risky than some student loans because students' payments fluctuate with their ability to pay. Federal loans with income-driven repayment options, primary source ISAs, and secondary source ISAs all share this feature. In contrast, private loan borrowers are penalized if they cannot make payments. This penalty comes in the form of accrued interest charges, extended time in debt, and fees for late payments. One researcher described an ISA as a "private loan with income-based repayment."

Because ISA payments are based on income, payments decrease when recipients earn less. "We like to say that when a student needs it the most, it costs the least, and when a student needs it the least, it costs the most. That aspect of the income-based payment I think is a downside protection," explained one funder.

Some experts mentioned that ISAs are less risky than private loans because private loans are nondischargeable in bankruptcy, whereas ISAs, they assume, would be. This assumption has yet to be tested. So far, no one has tried to discharge an ISA through bankruptcy. Courts may in fact treat ISAs like private loans, or they may decide that ISAs are classified as a different, dischargeable, financial product.

Pricing Pressure

Several experts noted that ISAs are uniquely suited to align the value of higher education to its price. From an ISA funder's perspective, it only makes sense to offer ISAs to students at institutions where upfront costs are reasonable given students' expected future income. If ISAs were offered at low-value institutions, ISA funders would have difficulty breaking even on their expenses. Thus, experts contend that ISAs would not be offered to students attending low-value institutions or enrolled in low-value programs. As one advocate explained,

> ISAs…put some limit on how much a student can take out. I mean, you can't take out an infinite sum with an ISA, because financially they can't work. So if you're trying to go to a school that's just really overpriced such that, even with the benefits of a college degree, the school is just so overpriced that it's just not going to work out, that's a case where it's more difficult to get an ISA because the school's just not offering the student value.

In this sense, ISAs would provide an upfront signal that could steer students away from enrolling in these low-value institutions. This signal would likely be more effective at institutions where most or all of the price is covered by an ISA. Secondary source ISAs also could be used to signal value, but this signal would be a smaller component of students' decisions.[2]

ISAs could have a stronger relationship to value if the ISA market were to expand substantially. Another advocate explained that a large ISA market that operated across multiple institutions could eventually spur cost reductions. Imagine that an ISA funder worked with two institutions that had the same tuition prices but different outcomes. The ISA funder could not reasonably offer the same upfront amounts for both institutions because the value of the institutions is different. To remain competitive, the lower value institution has a choice: it could try to improve its outcomes, or it could try to decrease its price. Decreasing its price would require cost savings. Assuming that it is easier to cut costs than to improve outcomes, low-value institutions would respond to a large ISA market by becoming more efficient and passing those savings on to students.

This scenario would necessitate strong agreement among ISA funders regarding what price-to-outcomes ratio is worth funding, as well as better information about the relationship between cost efficiencies and outcomes than is currently available. This scenario also would be more likely if most of the market growth was in primary source ISAs. Primary source ISAs could exert more pressure over institutions because the share of revenue they represent is larger than secondary source ISAs.

Weaknesses of ISA Market

ISA experts identified several barriers to the expansion of the ISA market. First, ISAs are complex financial products that students and the public struggle to understand. Second, many distrust ISAs, either because they are unknown or because some people prefer public financial

[2] In a previous study, AIR also found that students did not respond favorably to value signaling when shown different ISA terms by major (American Institutes for Research, 2016).

aid programs to private ones. Finally, a number of unresolved legal and regulatory issues make it difficult for ISA funders to find the financial backing they need to earn investors' and students' confidence.

Complexity

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. In fact, ISA funders are directly responsible for teaching students about their products. One advocate noted that student loan lenders are protected by safe harbor forms that disclose information about the loan terms to the borrower. "If you use a form, it doesn't matter if the consumer actually understood it. It's presumed they understood it," the advocate explained. This presumption does not apply to the ISA market. ISA funders are responsible for creating disclosures and ensuring that students understand them in a way that is unique to the ISA market. Over time, the public may become more familiar with the concept of ISAs, but the challenge of addressing gaps in financial literacy is unlikely to be resolved by ad hoc efforts.

Mistrust

Mistrust is another barrier to ISA expansion. ISA experts identified multiple reasons why the public is wary about using ISAs to pay for college. In some cases, mistrust stems from a general dislike for private funding in public education. One funder bemoaned the "politicization" of ISAs and had heard concerns that ISAs were "a conservative trick for privatizing higher ed."

Some people view ISAs as predatory. Another ISA funder argued that this view is a "misconstrued understanding" of how ISAs function, in which people believe that individual investors select individual students. In this view, ISA funders may try to persuade students to pursue more lucrative careers to maximize their investment. In reality, both primary and secondary source ISAs pool students together and set ISA terms for groups, not for individuals. ISAs might offer better terms for computer engineering majors than for French literature majors, but it is unlikely that students would ever be individually pressured to change career paths.

At the conceptual level, ISA experts acknowledge that some people are wary of investing in another person's future earnings, particularly if that investment yields a profit. Media coverage of ISAs has often included the words "slavery" (Clark, 2016; Floyd, 2015; Jeffries, 2013) and "indentured servitude" (Dwyer, 2015; Hankin, 2017; Hannon, 2013; Supiano, 2016; Williams, 2017). Of course, ISAs cannot fairly be compared to real human rights abuses. Rather, the vitriol of these accusations represents the extreme discomfort some feel toward the concept. One ISA funder told us about a government official who said that ISAs were "icky." Another funder had been advised that "everybody in D.C. thinks the worst thing that could possibly happen is that a college student would finance their education and end up paying more than if they had just borrowed." This view is not limited to bureaucrats. One of the experts we interviewed in this study expressed concern about ISAs' "moral underpinnings," noting that high-income students will not need to use ISAs because they are able to cover the costs out of pocket. Consequently, ISA funders would profit by funding middle- and low-income students. This situation is true of private loans, another expert noted, but people often do not think of loans in that way.

Legal Murkiness

A lack of statutory and regulatory clarity poses many barriers to ISA expansion. ISA experts had many suggestions for addressing these barriers. In part, laws and regulations could help improve public opinion about ISAs and convince students that they are trustworthy.[3] One expert compared ISAs to the insurance market, explaining that government intervention was partly responsible for expansion in the insurance market during the 19th century. By acknowledging ISAs, the government could lend legitimacy to ISAs in a similar way.

Legislation also could symbolically improve consumer protections. As one advocate argued, proposed legislation to protect ISA recipients does not address the current failings in the ISA market. Rather, ISA bills are based on standards that the industry already follows. The purpose of these bills is to ensure that industry standards will not be weakened, and in doing so, assure students and the public that ISA funders will continue to protect ISA recipients. One ISA funder pointed out that their ISA follows the consumer protections set for private loans, such as preferred lender regulations, despite the fact that they are not currently required to do so. By ensuring that their ISA complies with these standards, the funder can attempt to stave off legal challenges and simultaneously improve students' confidence in their product.

Increasing statutory and regulatory clarity also could help convince institutions and investors to partner with ISA funders. According to one concerned funder, investors are worried that "a judge can just toss these things out because there is no statutory or case law." If they cannot assure investors that legal challenges will not nullify their contracts, ISA funders face barriers to investment and growth.

Even if the ISAs were upheld in court, certain aspects of the contracts could undermine their value. For example, student loan borrowers have the right to accelerate their loan payments or to prepay their balances before they are due, which helps borrowers avoid making additional interest payments. Although it is prohibited to charge prepayment penalties on private student loans, ISA funders need to be able to charge students more if they end their contract early. One advocate argued that ISA recipients who earn more money have to pay more than recipients who earn less in order for the business model to work. If legislators decide that this additional payment amount should be treated like a prepayment penalty, it could jeopardize the ISA business model and make it difficult to attract investors.

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[3] The American Enterprise Institute (Holt & James, 2015) has examined consumer protection laws and regulations for ISAs in great detail.

Opportunities for Expansion

What opportunities lie ahead for the ISA market? In the short term, changes to federal student loans may open the door to a new group of ISA recipients. In the long term, changes in marketing strategies may expand public trust in ISAs.

Changes to Graduate PLUS Loans

ISA experts see opportunity on the horizon if Congress imposes borrowing limits on loans for graduate students. Currently, graduate students can borrow PLUS loans for up to the total cost of attendance. The average Grad PLUS loan amount was almost $24,000 last year (College Board, 2016). If graduate students were not able to borrow as much, they would need additional sources of financial aid to make up the difference. That would create an opening for enterprising funders offering secondary source ISAs. Two ISA experts predicted that Congress would move to limit graduate student loan borrowing in the near future. This change could make ISAs an attractive alternative for graduate students. The American Enterprise Institute recently recommended that the federal government eliminate loans to graduate students entirely (Delisle, 2017), which also could open the door to primary source ISAs for graduate students.

Better Marketing Strategies

ISA experts also mentioned several opportunities to market ISAs better, such as publicizing ISA recipients' success, gaining endorsements from public figures, and trying alternative messaging. Experts anticipate that ISAs will fare better after the market has had time to establish itself. Having more data on ISA recipients' success will encourage investors, institutions, and students to trust ISAs.

Outspoken ISA proponents can help raise the public profile of ISAs, as Mitch Daniels, the president of Purdue University, has done in Indiana. Senator Marco Rubio also has championed ISAs in Congress.

One researcher suggested that describing ISAs as "deferred tuition" could make it easier to explain ISAs to students. For example, primary source ISAs could tell prospective students, "Come to our school for free and, in exchange, you'll just pay us a fraction of your income over time." Rebranding ISAs using language that students will understand, rather than financial jargon, could help increase uptake. In fact, ISAs themselves used to be called "human capital contracts" in the economic literature (see, e.g., Palacios, 2004) until they were rebranded as income share agreements in 2013 (Google Trends, 2017).

Threats to Expansion

The ISA market exists to fill in the gaps that the federal student loan program cannot cover. Two changes to student loans could prevent ISAs from expanding their reach: expanding access to federal loans and increases in loan amounts.

Extending Federal Loan Access

Primary source ISAs are typically offered at nonaccredited institutions, like coding boot camps. If more institutions were given access to the federal student loan program, primary source ISAs could fall by the wayside. Extending access to student loans would likely require reforms to the accreditation system. There is certainly support for accreditation reform across the political spectrum. The American Enterprise Institute has proposed creating a new accreditation agency for innovative programs (Hess, 2017), programs like the ones that currently offer primary source ISAs. The Obama Administration's Educational Quality through Innovative Partnerships (EQUIP) program experimented with accreditation for coding boot camps and other alternative providers (U.S. Department of Education, 2016). It is unclear whether actual changes will pass through Congress anytime soon. For that reason, extending federal loan access is unlikely to seriously threaten the ISA market.

Increasing Student Loan Amounts

Secondary source ISAs are an alternative to private student loans or PLUS loans, which both help students make up the difference between Direct loans and their total cost of attendance. Currently, the largest Direct loan a dependent undergraduate student can borrow is $7,500 a year (U.S. Department of Education, Federal Student Aid, n.d.). If this amount were increased, students would have less need to seek additional types of financial aid. Depending on the size of the loan increase, ISA amounts could get smaller or ISAs could disappear altogether. Increases in loan amounts seem even less likely than accreditation reform. During his campaign, President Trump proposed expensive reforms to income-driven loan repayment (Douglas-Gabriel, 2016); increasing loan amounts would only drive up the cost of that proposal.

Conclusion

Are ISA experts right to be bullish on ISAs? We think so. Unlike Pay It Forward, another financial aid innovation that one researcher called "a dog that never barked," ISAs are likely to play a significant role in higher education policy debates moving forward for several reasons.

First, several companies currently offer ISAs to a wide variety of students. Our research indicates that ISA advocates and funders will continue to leverage partnerships with trusted institutions and capitalize on concerns about the labor market to expand the ISA market.

Second, ISAs have powerful champions who can create an environment conducive to market growth. Already, investors' legal concerns and consumer advocates' desired protections have been addressed in several bills (H.D. 3432, 2015; S. 2186, 2015; S. 268, 2017).

Third, possible graduate student loan reforms could further expand ISA opportunity. Changes to the Grad PLUS loan program, if they gain steam, could be a huge win for ISAs, and it's unlikely that ISAs will face major threats even if Grad PLUS stays the same.

As the ISA market expands, further research will be needed to determine how ISAs work in a variety of settings. Do primary source ISAs really incentivize efficiency without harming quality? Do students really substitute secondary source ISAs for Parent PLUS and private loans? Do students change their employment plans to avoid paying ISA funders more than they received upfront? Researchers should investigate whether students' and institutions' behaviors correspond to ISA funders' expectations.

In 2017 and beyond, ISAs will continue to carve out a niche in the financial aid market. This growth will be worth watching.

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