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Income Share Agreements on Campus

A PRACTICE GUIDE

DECEMBER 2015

Introduction

Next fall, students at Purdue University may have a new way to pay their tuition: income share agreements (ISAs; Purdue University, 2015). ISAs are an alternative form of higher education financing in which students pledge a fixed percentage of future earnings in exchange for money to pay for college (see How ISAs Work). As we show in *The Potential Market for Income Share Agreements Among Low-Income Undergraduates* (American Institutes for Research, 2015), ISAs are not common. If ISAs increase in frequency, they will present a new challenge to the nation's colleges and universities, which do not have guidance from the U.S. Department of Education (ED) or professional associations on how to treat ISAs when either awarding student aid or reporting data to the federal government. For institution-related ISAs, these administrative concerns are pressing. Purdue and other similarly interested institutions will have to decide how to include ISAs in students' financial aid award letters and how to report these funds to ED.

What is the likely impact of ISAs on how campus financial aid offices will award student aid? What are the implications of ISAs for campus reporting on student aid? In this brief, we address these two questions, drawing on the generous assistance of the National Association of Student Financial Aid Administrators (NASFAA). NASFAA asked a small group of its members to share their experiences with ISAs on campus and, absent such experience, how they planned to award and report on this type of aid. Absent any real-world experience with ISAs, most of these members responded that, hypothetically, they would package ISAs as estimated financial assistance and report them as private student loans. This approach could affect the type and amount of other financial aid that students receive.

How ISAs Work

In an ISA, a beneficiary receives up-front funding for educational expenses from an investor. In exchange for that funding, the recipient agrees to share a portion of his or her income with the investor for a set period of time. In some regard, the terms of an ISA mirror those of existing federal student loan programs. Anecdotally, the typical length of an ISA is 10 years, and the percentage of income shared rarely exceeds 10 percent of a student's adjusted gross income. ISA terms may vary depending on the price and the length of an educational program. Often, the recipient-funder relationship is brokered by a third party, which may be either a for-profit or nonprofit corporation. Often, the third party also fills the role of servicer, verifying a recipient's income using tax or payroll statements and handling monthly payments.

This is the second of a series of Issue Briefs dealing with ISAs.

Financial Aid Officers' Awareness of Students' Use of Income Share Agreements

Would students inform financial aid officers if they received an ISA? In the case of institution-related ISAs, such as the program under development at Purdue University, financial aid officers would be aware of students' participation and may even be responsible for disbursing the funds. Whether financial aid officers would have the same knowledge of independent ISAs is far from clear. One financial aid officer raised the following concern:

> [T]here's still such a thing as private loans that don't require school certification. I imagine that ISAs can easily keep the financial aid office out of the loop. And that's a potential problem for the provider because they might not be knowledgeable enough to know how to determine what the student really needs. The potential could be there for a student who has aid to still go to the ISA provider for funding up to the full [cost of attendance].

No reliable mechanisms exist for campus professionals to learn whether a student is using an ISA. Although the vast majority of private education loans require school certification (Consumer Financial Protection Bureau, 2012), no such requirement exists for ISAs. Similarly, no financial aid officer we spoke with identified a clear and consistent way in which students were asked to report ISAs to institutions. Finally, neither the Free Application for Federal Student Aid (FAFSA) nor the CSS/Profile contains questions that specifically elicit information about ISAs from students or parents.[1] School certification, already understood by most financial aid officers, appears to be the simplest solution. Several institution-related ISAs are working to incorporate school certification into the origination and verification process and address these problems.

Absent a consistent process, two problems arise. First, institutional compliance with federal rules governing aid packaging—and the wise use of financial aid funds—is substantially complicated when financial aid officers are not aware of all the ways in which a student is financing his or her education. Equally as problematic is the challenge this presents to financial aid officers who would otherwise facilitate conversations with students and families about how to understand an ISA relative to a grant or an education loan. Consequently, students risk making poor financial decisions, diminishing the very benefit this innovation in student aid seeks to offer.

Income Share Agreements and Aid Packaging

Even when financial aid officers are aware that a student has an ISA, this may pose challenges for financial aid packaging (i.e., the process of awarding aid to meet a student's financial need). According to ED,

> Packaging is a process that varies from school to school, depending on the types of scholarship and other aid available at the school, and the characteristics of the student population. Schools may have different packaging philosophies, but they generally try to find the best combination of aid to meet the financial need of the students they serve. (Federal Student Aid, 2015, page 3-137)

Federal regulations prevent financial aid officers from awarding students more than they need to cover the cost of attendance (COA; i.e., tuition, room, and board). The regulations also specify the order in which different types of aid

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should be awarded, but none of these regulations mention ISAs. This uncertainty places financial aid officers in the difficult position of determining how to prioritize ISA funds when packaging several types of financial aid.

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One U.S. Department of Education official with whom we spoke stated the following:

> [B]ased on the information we have today, we would consider payments through ISAs to be "estimated financial assistance" that would affect students' eligibility for all Title IV aid besides Pell Grants. In general, we treat a resource as estimated financial assistance if it is only received because the student is enrolled in a postsecondary program, but it is not a form of employment. ISAs appear to meet those criteria.

According to the 2015–2016 *Federal Student Aid Handbook*, estimated financial assistance (EFA) is aid that a student receives from the institution (or an individual outside the institution) because the student is enrolled in a postsecondary program (Federal Student Aid, 2015). Examples of EFA include scholarships, federal Direct Loans, PLUS loans, Federal Work Study (FWS), and private loans. When packaging student aid, a financial aid officer will first look at a student's expected family contribution (EFC) to determine whether the student is eligible for a Pell Grant and then package EFA (Federal Student Aid, 2015). Institutions have some discretion in how they prioritize different types of EFA during packaging, such as prioritizing students with greater need.

If ISAs were considered EFA, they would not affect students' eligibility for Pell Grants or Iraq and Afghanistan Service Grants. However, ISAs could be considered when awarding other forms of need-based aid, such as FWS and Direct Subsidized (need-based) Loans (Federal Student Aid, 2015). In addition, ISAs could have an impact on non-need-based aid. Where a student's COA is larger than the annual Direct Unsubsidized (not need based) Loan maximum, an ISA could replace other sources of borrowing, such as PLUS loans or private loans.

The effect of an ISA on EFA depends on the ISA's size and a student's COA. For example, imagine a third-year undergraduate student, Carl, qualifies for a Pell grant, a Subsidized Direct loan, and an Unsubsidized Direct loan. If Carl receives a $5,000 ISA, his Unsubsidized Direct loan amount will change so that his aid package does not exceed his total costs (Table 1).

Table 1. Carl's Financial Aid Package: Scenario 1

	Before ISA	After ISA
COA	$15,500	$15,500
Pell Grant	$4,825	$4,825
Direct Subsidized Loan	$5,500	$5,500
ISA	$0	$5,000
Direct Unsubsidized Loan	$2,000	$175[a]
Unmet COA[b]	$3,175	$0

[a] Schools are allowed to process Direct Loan amounts less than $200, although they are not required to do so.

[b] Unmet COA is a calculation of the difference between a student's costs and financial resources. It does not include EFC, which is an index used to determine a student's eligibility for need-based financial aid, such as Pell Grants. However, EFC is not the amount of money that a family must pay.

In this scenario, Carl's ISA funds help him cover $3,175 of his unmet COA. However, it also replaces most of his Unsubsidized Direct Loan. By accepting the ISA, Carl loses access to a federal student loan with generous repayment terms, such as a six-month grace period after leaving school and the option to enroll in income-driven loan repayment.

If Carl receives a larger ISA, it also could replace some of his need-based aid. In this scenario, Carl would still receive a Pell Grant, but the ISA would replace both types of direct loans because a student whose total financial aid exceeds his or her COA cannot receive any federal financial aid from programs offered under Title IV of the Higher Education Act, with the exception of a Pell Grant (Table 2).

Table 2. Carl's Financial Aid Package: Scenario 2

	Before ISA	After ISA
COA	$15,500	$15,500
Pell Grant	$4,825	$4,825
Direct Subsidized Loan	$5,500	$0
ISA	$0	$15,000
Direct Unsubsidized Loan	$2,000	$0
Unmet COA	$3,175	**-$4,325[a] (surplus)**

[a] When adjusting for an ISA, a financial aid officer cannot decrease the Pell Grant amount because Pell Grants are considered entitlements. A student can exceed COA with only Pell Grants and other non-Title IV forms of estimated financial assistance, such as an ISA.

Before receiving an ISA, Carl needs to find $3,175 to pay for his college costs. But if he uses an ISA, his total COA is met, and he has money left over from the Pell Grant. His federal loans have been eliminated because an ISA is added to his financial aid package.

Having $4,325 in additional funds should not be Carl's sole reason for choosing an ISA in this second scenario. If he plans to earn a lot after college, an ISA could cost him more in the long run. For example, if his starting salary is $35,000 per year after graduation and he has to pay 10 percent of his earnings for 15 years, the repayment would be $49,525, even starting with an extra $4,325 in the bank. (This estimation is based on the median income after college and 5 percent annual growth in income, ending at $69,300 after 15 years.) On the other hand, if Carl prefers not to take on any student loan debt, then an ISA would an attractive alternative. Carl would benefit from guidance from a financial aid officer, who could help him understand these trade-offs.

Ultimately, federal policymakers will determine how campus financial aid officers are to treat the financial support ISAs offer their recipients. Until that guidance arrives, however, aid administrators will be left to wonder about an ISA's implications for awarding financial assistance. For institutions that are actively exploring ISAs, such as Purdue University (2015), this issue will have to be addressed soon.

Income Share Agreements and Campus Reporting on Student Aid

If ISAs grow in frequency, institutional research and financial aid offices also would be expected to report to federal authorities on ISAs. On this issue, as with award processing, guidance has not yet been received from ED. As more ISAs are used to meet education expenses, the extent of students' financial obligations after graduating from college will be underreported.

One of the principal reporting requirements for institutions participating in programs authorized under Title IV of the Higher Education Act is to the Integrated Postsecondary Education Data System (IPEDS). Institutions, typically through their institutional research offices, are to report through the IPEDS Student Financial Aid component on the award of federal, state, institutional, and private aid (National Center for Education Statistics, 2015). The Student Financial Aid component of IPEDS itself contains no reporting instructions on the treatment of ISAs, and neither do key supporting materials, such as the IPEDS glossary and training materials, that campuses use to complete IPEDS surveys (Association for Institutional Research, 2014).

Institution-related ISAs that follow a school certification process and develop processes to collect data on recipients will be able to report student totals, aggregate funds received, and average award amounts. If other ISAs are reported at all—again, it is hard to report something the financial aid office knows nothing of—most aid administrators reported they would include ISAs in their accounting of private student loans. Although most acknowledge these products are not loans, the alternative is to report them as private grants. However, because Federal Student Aid training materials currently specify that private grants include only those funds disbursed through the financial aid office, this reporting avenue appears closed for ISAs that are not institution related with a campus-based certification and payment process (Association for Institutional Research, 2014).

IPEDS is far from the only reporting requirement placed on Title IV-participating institutions. These institutions also must meet a range of other Federal Student Aid reporting requirements, including documentation of student loan counseling and lists of preferred private lenders. These reporting requirements are not poised to accommodate the potential growth in ISAs. The *2015–2016 Federal Student Aid Handbook,* which weighs in at a voluminous 1,299 pages, does not contain a single reference to ISAs. Federal student aid training resources (Federal Student Aid, n.d.b) and Dear Colleague Letters (Federal Student Aid, n.d.a) also make no mention of ISAs.

As ISAs become more common, the lack of clear reporting requirements will have repercussions on the quality of data that informs policymaking, accountability, research, and consumer information. Students, administrators, and the public will be unable to discern how many students receive ISAs (and the terms of these agreements), and comingling reporting on ISAs with that of other forms of aid, such as private loans, makes existing data about those products less useful. Additional qualitative data, such as the names of ISA funders who have developed partnerships with an institution, also could benefit students, aid administrators, and regulators.

Conclusion

Financial aid administrators navigate uncharted waters when students receive ISAs. Without clear guidance or standards for processing these funds or reporting them to ED, administrators have no choice but to use their best judgment. At best, this situation leads to inconsistency. At worst, students could take large financial risks with insufficient information, and administrators could be held responsible for inaccurate federal reporting.

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Our preliminary exploration indicates that many financial aid administrators would likely package and report ISAs as if they were private student loans. Because ISAs require financial aid administrators to create nonroutine procedures for award packaging and data reporting, institutions should include financial aid officers when developing and implementing ISAs on campus. It is equally important for financial aid offices to have a seat at the table when an institution considers partnering with an external firm to offer ISAs. Collaboration across different offices within the institution will facilitate better planning and implementation.

How might uncertainty be resolved? Student aid administration is guided by statute, by regulation, by subregulatory guidance offered by ED through Dear Colleague Letters (Federal Student Aid, n.d.a), and through instructions and training offered in Federal Student Aid publications, such as the *Federal Student Aid Handbook* (Federal Student Aid, 2015). As of December 2015, ISAs were not addressed in statute, regulation, subregulatory guidance, or instructional materials, and ED did not have plans in place to develop guidance. As one ED official noted, “We have not seen enough actual examples of ISAs at work, and because we have not yet received the question from the field, we have no immediate plans to publish guidance on this topic.”

Although only ED can provide authoritative guidance about the treatment of ISAs under federal student aid methodology, the financial aid community can help identify what its most experienced and knowledgeable members are doing to incorporate ISAs into the administration of aid. The financial aid community should share these experiences and best practices with ED as well as the Consumer Financial Protection Bureau. This collaboration would help ensure that the federal government has the knowledge base needed to monitor and provide guidance to the field regarding ISAs.

Endnote

1. However, students may include ISA funds as money paid on the student's behalf (question 45j on the paper version of the FAFSA). This could be prevented by changing "someone" to "a friend or a relative (not a parent or funder)." See https://fafsa.ed.gov/fotw1516/help/totalMoneyReceived.htm for more information.

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1000 Thomas Jefferson Street NW
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