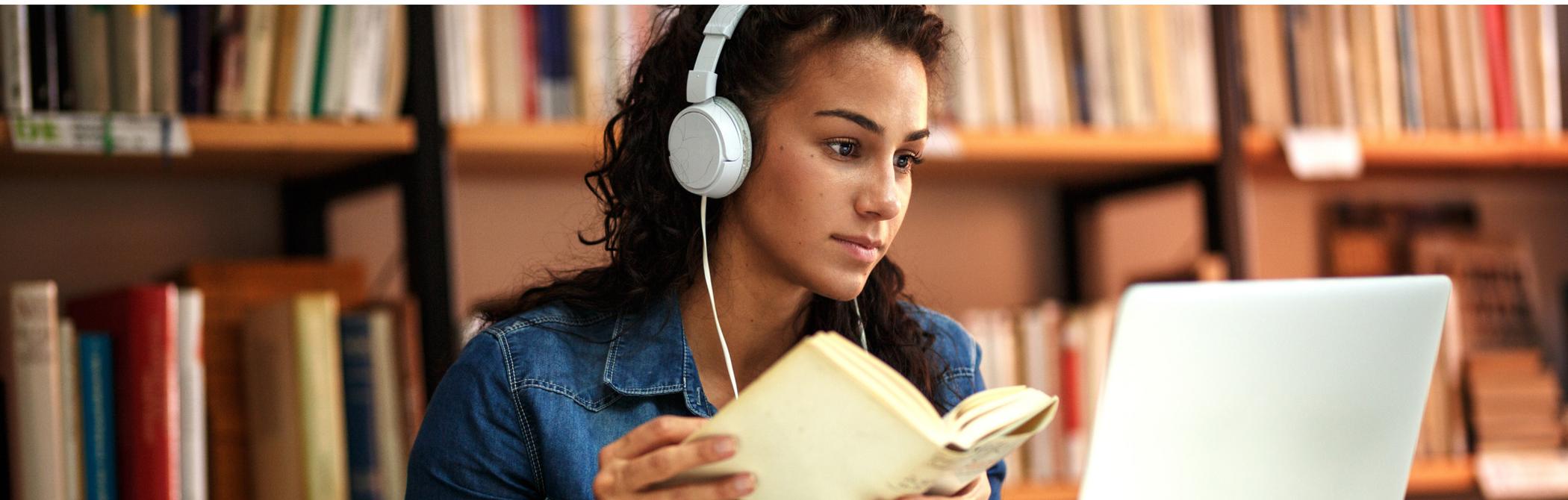


# Unlocking the potential of ISAs to tackle the student debt crisis

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# EXECUTIVE SUMMARY

With one million defaults on student loans every year, and \$1.6 trillion in outstanding student debt, it's clear the US is in desperate need of innovative funding models in higher education. Income Share Agreements, or ISAs, stand to provide a promising alternative to high-risk student loans, as they better align the interests of students, schools, and lenders.

In an ISA, students pay no tuition upfront, only repaying the education provider once employed—in essence, funding today's educational opportunities for a fixed percentage of tomorrow's income, within a set window of time. In other words, an ISA is an equity investment, whereas a student loan is a debt burden.

ISAs have the potential to both protect students from paying for educational experiences that don't create value for them in the labor market, shifting the risk of poor workforce outcomes away from students, and to produce better outcomes by putting that risk on schools and giving them skin in the game. After all, education providers are more likely to help students graduate and get good jobs if that's how the schools get paid. Aligning incentives between schools, capital providers, and students could redefine the value of college.

ISAs thus serve as a viable choice for students seeking to finance their education, and in many cases, increase access to higher education by helping students afford programs not eligible for federal financial aid.

Despite the potential of the ISA model, a lack of regulatory clarity has limited its adoption. To reach that potential, the ISA market needs guardrails that both protect students and encourage investment in the space. The recently proposed ISA Student Protection Act of 2019 gives policymakers an opportunity to establish clear rules of the road for the ISA market.

- First, the ISA market should be bounded by a **minimum income threshold**, limiting downside risk for students in cases of unemployment or underemployment. The current bill's proposal to index this threshold to the Federal Poverty Line is a strong first step.

- Second, the ISA market needs **payment caps** to keep students from paying exorbitant amounts. The current bill limits both the percentage of income and a value known as the "commitment factor," striking a good balance of protecting students while giving ISA providers room to experiment with different types of caps.
- Third, the ISA market needs **greater transparency** to help students make informed decisions when considering ISAs, and to help ISA providers understand the legal framework in which they operate. The current bill offers a legal definition of ISAs, and clarity around their treatment under tax and consumer protection laws.

With clearer rules of the road, ISAs will be better positioned to address the needs of those for whom existing solutions aren't working. We welcome ISAs as an innovative addition to the higher education financing toolbox, and encourage Congress to do the same.

Education providers are more likely to help students graduate and get good jobs if that's how the schools get paid.

Redistributing the risk of poor outcomes has the potential to redefine the value of college.

## INTRODUCTION

One million borrowers default on their student loans every year.<sup>1</sup> This evidences a deeply troubling mismatch between what colleges and universities charge and what they help their students earn as a result of that investment. Income share agreements (ISAs), an outcomes-based funding model that allows students to fund today's educational opportunities in exchange for a fixed percentage of tomorrow's income, protect students against poor workforce outcomes, shifting that risk to schools and incentivizing the latter to better prepare their students for the labor market. Redistributing the risk of poor outcomes has the potential to redefine the value of college.<sup>2</sup>

However, the lack of a regulatory framework for ISAs has been a significant hurdle to realizing their full potential. Many education providers and investors hesitate to implement a financing model that lacks legal assurances of student protections and clarity around issues like tax treatment and dischargeability in bankruptcy.

The American government already has a long history of legislatively coaxing America's colleges and universities to evolve beyond their origins as the exclusive stomping grounds of the elite.<sup>3</sup> The time has come to once again create and pass innovative legislation for an evolving economy.

ISAs have slowly gained bipartisan support, overcoming the ideological concerns of many about the role of private capital in education markets. The recently proposed ISA Student Protection Act of 2019<sup>4</sup> provides policymakers with a tremendous opportunity to establish clear rules of the road for the ISA market, and thus unleash its potential.

In this policy brief, we provide an overview of ISAs and examples of ISAs currently in operation. We then explore guardrails that are essential to effective ISA legislation and analyze the ramifications of these provisions for students, education providers, and other ISA market participants. In so doing, we hope to empower policymakers as they unlock the power of a financing tool that has the potential to revolutionize higher education.

## ISA PRIMER

In an ISA, students pay no tuition upfront, only repaying the education provider once employed, and as a fixed percentage of their earnings, or **income share**, during the payment term. The **payment term** is the maximum number of monthly payments the student agrees to make within a fixed window of time. For example, the payment term at Lambda School, a coding bootcamp, consists of 24 monthly payments made over, at most, five years following graduation.<sup>5</sup>

In a typical ISA, students are only required to make payments when their income exceeds a **minimum income threshold**. When a student's income is below this threshold, the student does not pay. In practice, minimum income thresholds range from an annual salary of \$20,000 to \$60,000.

ISAs also have **payment caps**, a ceiling to the total amount that students can pay over the payment term.

An ISA contract is fulfilled when:

1. The student makes the required number of payments, whether the total amount paid is less than or greater than the initial funding amount;
2. The student reaches the payment cap; or
3. The payment term ends.

A side-by-side comparison with loans is instructive. With ISAs, monthly payments begin once a student's income exceeds a contractually agreed upon threshold (the minimum income threshold). The monthly payment amount is typically a fixed percentage of income. The student pays for a set payment term, even if the total amount paid back is less than the initial funding amount.

With traditional student loans, the monthly payment amount is fixed, regardless of income (or lack thereof), and the student pays until she has paid back the principal, plus interest. In short, an ISA is an equity investment, whereas a loan is a debt burden (see Figure 1).

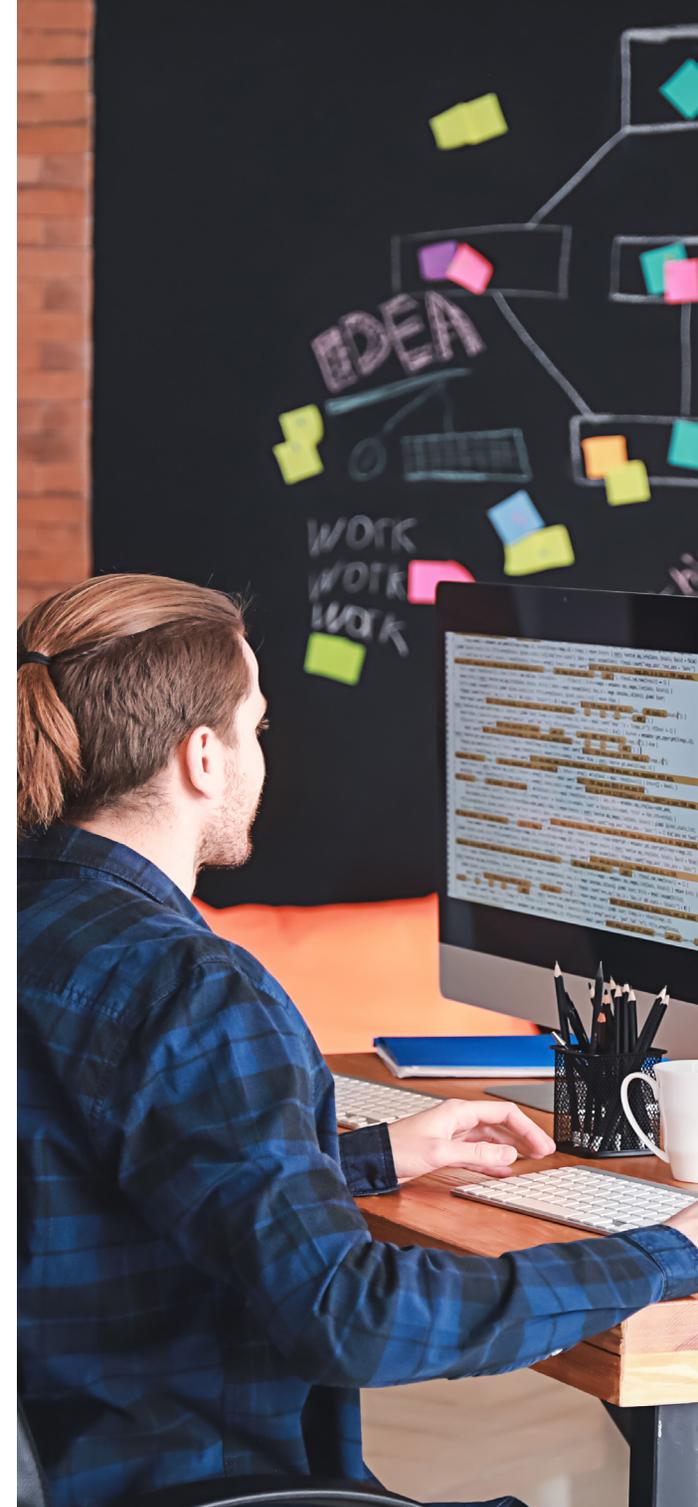
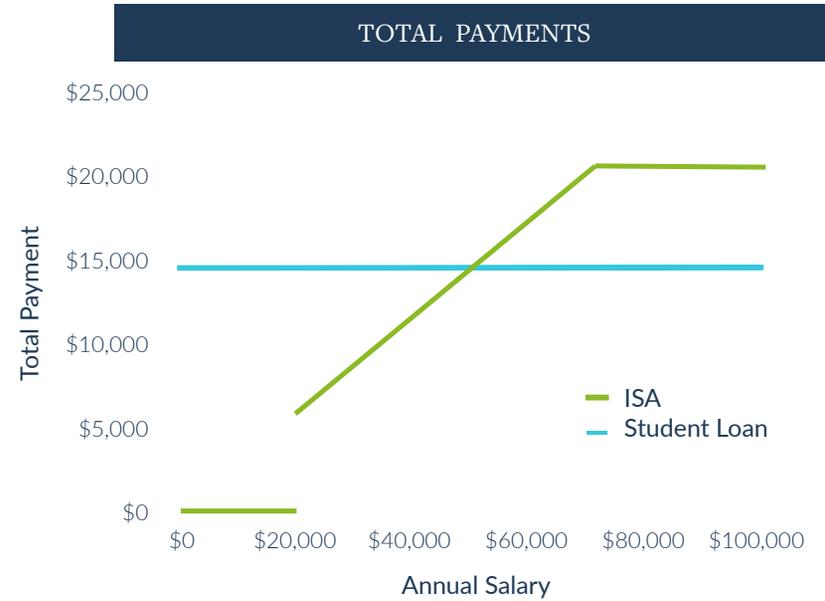
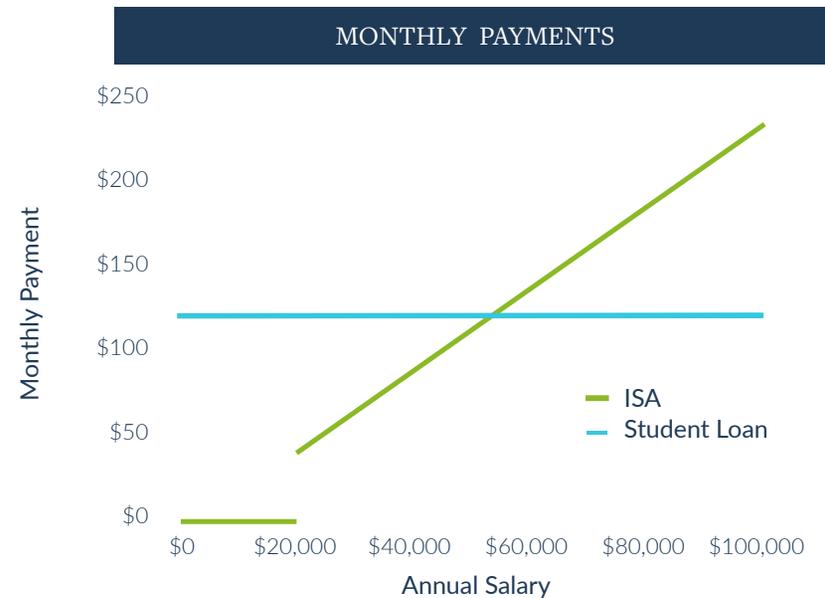
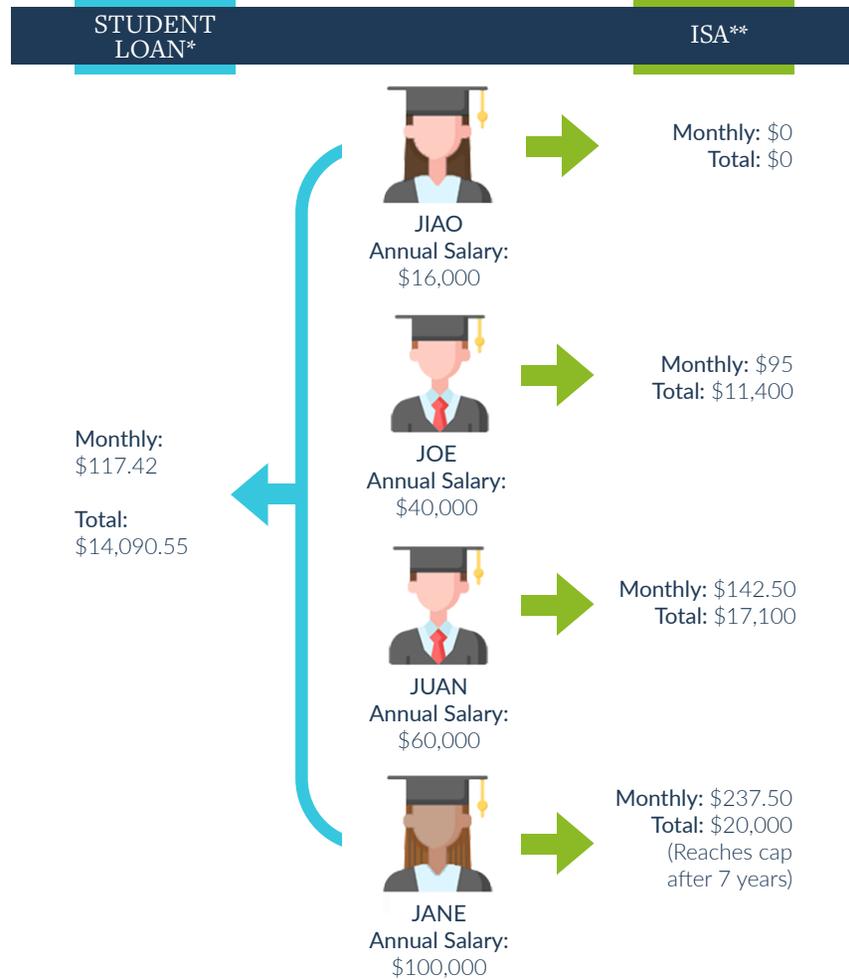


Figure 1. Repayment comparison for \$10,000 student loan vs. ISA



\*For this hypothetical loan, we assume a term of 10 years, charging an interest rate of 7.50%. Actual loan terms will vary depending on a variety of factors, including whether a student is borrowing in private markets or using federal loans, and/or whether they are undergraduate or graduate students. We assume the salary remains the same during the 10-year period.

\*\*For this hypothetical ISA, we assume a term of 10 years, with an income share of 2.85%, a minimum salary threshold of \$20,000, and a payment cap of 2x the principal. We assume the salary remains the same during the 10-year period.

# HOW ISAs ARE USED TODAY

ISAs are spreading throughout higher education, among both traditional institutions and alternative providers (see Figure 2).<sup>6</sup> Across these increasingly diverse contexts, the mechanisms of ISAs are similar, but the purposes of these contracts vary widely.

Traditional colleges and universities are using ISAs to increase both options and access for students. Institutions implementing ISAs typically use them to plug funding gaps for students who have exhausted their federal financial aid options, or who are debt averse. Purdue’s Back-a-Boiler program, for example, offers ISAs with terms that are competitive with private student loans, giving students an option that has better downside insurance against poor outcomes. Purdue’s ISA program, like that of many other schools, is not meant to replace federal student loans, but rather to supplement them.

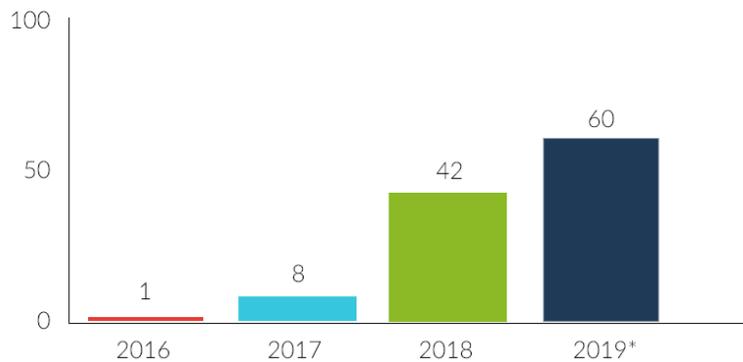
Other ISA programs, like Colorado Mountain College’s Fund Sueños, are designed to increase access. Fund Sueños aims to help students who fall

under the category of Deferred Action for Childhood Arrivals (DACA) finance their college education. Given their undocumented status, these students can’t access Title IV funding, the current model for federal financial aid found in the Higher Education Act (HEA) that includes federal loans, grants, and work-study programs.

A second kind of entity includes alternative providers, like coding bootcamps, for students seeking education and training. Students interested in alternative providers also cannot access federal financial aid—these programs are ineligible for Title IV funding. Alternative providers use ISAs to make their programs accessible to students.

A third kind of entity is entering the ISA market as well: non-profit workforce development boards. The San Diego Workforce Partnership (SDWP), in partnership with the University of California San Diego Extension school, recently kicked off its philanthropically-funded Workforce ISA Fund to address both a decrease in government funding and growing skill shortages in San Diego’s labor market. The program is geared towards job-seekers looking to launch new careers and who need financial assistance to pay for short-term training courses. SDWP provides tuition funding and wraparound services, then uses students’ ISA payments to cover costs and fund the training of future students. If this “renewable learning fund” model catches on, it will facilitate lifelong learning pathways and potentially transform workforce development.<sup>7</sup>

**Figure 2: Number of Vemo clients**



\* Through July 2019

Vemo is an edtech company founded in 2015 which designs and facilitates ISA programs for educational providers. Here, we use Vemo’s growth as a reflection of the overall growth in the ISA market—a nascent market for which no perfect dataset exists.

## A new value network forming

As a growing number of educational providers enter the ISA market, a range of companies are emerging to form a new value network around ISAs, helping schools to structure and operate ISA programs, access capital, and offer additional services for ISA students.

# PURDUE UNIVERSITY

**Program:** Back a Boiler

**Institution type:** degree-based university

**Goal:** To provide another choice of funding options for students that could reduce debt and financial risk for graduating students

**Third-party ISA provider:** Vemo

**Start date:** 2016/17 academic year

**Financial terms:**<sup>8</sup>

- Initial funding: Minimum \$5,000 for academic year; minimum \$2,500 for summer. Maximum depends on major and year in school, ranges as high as \$34,000 for academic year.
- Payment cap: 2.31x initial funding amount
- Income share: 1.73 to 4.58% depending on major, for every \$10,000 of funding
- Payment term: 80 to 116 monthly payments, depending on major<sup>9</sup>

**Funding:** Purdue, Purdue Research Foundation, and outside investors, who have raised a total of \$16.4 million between two private placement funds.

Education providers typically hire third parties to facilitate ISA design and implementation. Companies like Vemo and Leif help schools design their ISA programs, offer online platforms for monitoring and managing ISA portfolios, and take care of income verification and payment handling. Vemo works with both alternative providers as well as traditional institutions, whereas Leif focuses only on alternative providers.

Funding for ISAs comes from a range of sources. While traditional institutions might be able to fund their ISA programs through their endowments or other fundraising capacities, alternative providers usually rely on outside investors for upfront capital. In most cases, this entails venture capital fundraising or working with investment management companies. One company working to expand the sources of capital flowing into the ISA market is edly, which in October 2019 is launching the first online ISA marketplace where accredited investors can purchase shares of ISAs.

Some capital providers are looking to do more than just invest. MentorWorks Education Capital is premised on the notion that as a capital provider with a vested interest in student outcomes, it should facilitate mentoring and employer connections for the students whose ISAs it funds. The company developed a networking platform whereby students, once employed, reduce their own income share payments by mentoring future students.



**Institution type:** Coding bootcamp

**Goal:** To fund a student's entire coding bootcamp tuition

**Third-party ISA provider:** Leif

**Start date:** Q4 2017

**Financial terms:**<sup>10</sup>

- Initial funding amount: \$20,000
- Minimum income threshold: \$50,000/year
- Payment cap: 1.5x initial funding amount
- Income share: 17%
- Payment term: 24 monthly payments over a maximum of 5 years

**Funding:** Multiple venture capital firms

## THE POTENTIAL OF ISAs

### ISAs shift risk away from students

On average, education pays off.<sup>11</sup> But not everyone experiences an “average” outcome. For many students, especially the million students per year who default on their loans, the cost of their educational experiences isn't worth it financially. Student loans are difficult to discharge in bankruptcy, and in traditional loans the payments are fixed—meaning that students with low salaries may find they are unable to pay their loans. In traditional loan programs, the risk of poor return on investment is held by the individuals who borrowed to further their education.

ISAs shift that risk to schools and investors. For students who experience poor outcomes in the labor market, their ISA payments will fall commensurately with their salaries—and if their income falls below the minimum threshold of their contract, they don't pay at all. This protects students from paying for educational experiences that don't create value for them in the labor market—and it shifts that risk to those on the other side of the ISA contract: schools and investors.

### ISAs can lead to better student outcomes

In the context of skyrocketing tuition and a student debt burden of stunning proportions, the potential of ISAs to shift downside risk away from students offers a compelling value proposition.<sup>12</sup> But ISAs offer additional benefits that could have an even larger impact, driving not only affordability but also workforce outcomes.

ISAs reduce the trade-off between student protection and institutional innovation that arises within pay-for-enrollment models, allowing schools to experiment with inputs while maintaining accountability for student outcomes. ISAs create financial incentive alignment between education providers, capital providers, and students. Unlike the student loan system, wherein schools earn the same amount of tuition revenue regardless of whether a student does well or poorly after graduation, ISAs tie the school's fate to that of its graduates, incentivizing schools to teach workforce-relevant skills, provide support to improve retention and completion, and help students navigate the job market. Where the current student loan system promotes access to admission, ISAs could promote access to socioeconomic mobility.



**Program:** Workforce ISA Fund

**Institution type:** nonprofit workforce development board

**Goal:** To fund training for high-demand jobs in light of reduced government funding, especially for those without other financing mechanisms

**Third-party ISA provider:** Vemo

**Start date:** Applications opened April 2019, first classes started July 2019

**Financial terms:**

- Initial funding amount: \$6,500
- Minimum income threshold: \$40,000/year
- Payment cap: 1.8x initial funding amount
- Income share: 6 to 8%, depending on course of study
- Payment term: 3 to 5 years, depending on course of study

**Funding:** \$3.5 million from a coalition of funders including Google.org, The James Irvine Foundation, Strada Education Network, and individual donations

Part of this, in practice, revolves around increased transparency for students regarding different programs' return on investment. As institutions collect tuition revenue for individual programs through ISA payments, they may adjust ISA terms to account for program ROI. This transparency could also reveal to institutions their true strengths, and where they add less economic value. ISAs thus have the potential to serve as a signal of value and an additional data point around institutional and program quality.

This incentive alignment potential holds even in more complex financing scenarios. In a scenario in which an outside investor originates the ISA, advancing funds to schools such that their profit formulas aren't as directly impacted, schools will still need to establish processes that optimize for student outcomes. Investors are unlikely to channel funds to schools that lose them money.

Thus the incentives that ISAs can create for education providers make them more than just another way to pay for school. Education providers are more likely to help students graduate and get good jobs if that's how the providers get paid.

Where the current student loan system promotes access to admission, ISAs could promote access to socioeconomic mobility.



**Program:** Invest in U

**Institution type:** degree-based university

**Goal:** To help more students graduate; focus on seniors close to graduation and in need of extra financial resources to complete

**Third-party ISA provider:** Vemo

**Start date:** Fall 2019, pilot phase

**Financial terms:**

- Initial funding amount: \$3,000 to \$10,000
- Minimum income threshold: \$20,000/year
- Payment cap: 2x initial funding amount
- Income share: 2.85% for all majors
- Payment term: 3 to 10.5 years, depending on initial funding amount

**Funding:** \$6 million fund comprised of donations, university funding, and impact investments from family foundations and friends of the university

## TO REACH ITS POTENTIAL, THE ISA MARKET NEEDS GUARDRAILS

The growing use of ISAs belies the market's relative infancy. The ISA market can be measured in tens of millions of dollars, which pales in comparison to a student loan market worth trillions. There isn't even a legal definition for ISAs, whereas there is a long list of federal and state laws defining and regulating debt, in addition to Title IV of the HEA authorizing multiple loan programs and a 1,424-page manual for schools looking to comply with Title IV rules.<sup>13</sup>

This early stage of ISA market development offers a critical window to establish guardrails around ISAs, giving lawmakers an opportunity to head off exploitative practices. There is also, however, the potential for overzealous legislation to needlessly constrain innovators trying to optimize this financing model. As policymakers review the recently proposed ISA Student Protection Act of 2019, understanding the trade-offs built into different ISA contract terms will help optimize the impact of the nascent ISA market by both protecting students and incentivizing innovation that improves student outcomes.

This early stage of ISA market development offers a critical window to establish guardrails around ISAs, giving lawmakers an opportunity to head off exploitative practices.

## Guardrail #1: Minimum income thresholds

A healthy ISA market should be bounded by a minimum income threshold below which students either do not pay or defer payments until their earnings exceed that threshold. This limits downside risk for students, particularly in cases of unemployment or underemployment. There are trade-offs in considering where this minimum income threshold should be set.

### The lower the threshold, the higher the risk for students

First, students with lower incomes spend a greater percentage of their income on basic needs than do those with higher incomes. For instance, if the minimum income threshold is set at \$20,000 per year, a student earning \$21,000 is still at risk of struggling to meet basic needs after paying 10% of her income.

Second, a lower threshold opens the door to students making payments even if underemployed. A high school graduate working full-time in Q2 2019 could expect weekly earnings of \$751,<sup>14</sup> which equates to roughly \$39,000 per year. If a college sets its threshold at \$35,000, its graduates could earn less than the average worker who never went to college, and still pay tuition under that college's ISA terms.

### The higher the threshold, the higher the risk for education providers and investors

Because education providers and investors do not earn any tuition revenue unless their students' earnings exceed the minimum income threshold, raising this floor could mean a loss or delay of revenue from lower-earning student graduates. This could incentivize stakeholders to help students achieve more lucrative workforce outcomes.

Raising the minimum income threshold too high could also discourage investment in the space. Institutions funding ISA programs from their endowments or financial aid budgets need these programs to be sustainable. If their graduates get jobs in areas with relatively lower wages, ISA programs whose minimum income thresholds are too high could sink very quickly. Also, capital providers funding programs like bootcamps invest with the purpose of generating positive returns. The point is for institutions to have

skin in the game—not a pound of flesh. Policymakers must therefore be careful to balance student protection with market growth: making ISAs out of reach for capital providers also makes them out of reach for students.

### Defining the minimum income threshold

A guardrail around minimum income thresholds is crucial to protecting students against poor outcomes. Legislation should mandate that all ISAs incorporate minimum income thresholds.

Most likely, the free market will set thresholds well above a mandatory minimum. For instance, in the bootcamp space, income thresholds start around \$40,000 per year, and range as high as \$60,000. Despite a lack of regulation, these providers haven't made ISA terms a race to the bottom. Instead, competition for students has led to higher income thresholds. However, it would be unwise to leave room for unethical providers to set a meaninglessly low token number. Policymakers should set a minimum income threshold as insurance against such unintended consequences.

Recently proposed legislation<sup>15</sup> indexes this minimum income to 200% of the Federal Poverty Level, thus accounting for inflation. Tying the minimum income threshold to this living metric is a strong step forward in the development of a healthy ISA market. An index that accounts for regional cost-of-living could also be appropriate, albeit difficult to implement. We would consider such a measure an ambitious, but potentially important, step as the ISA market develops.

## Guardrail #2: Payment caps

Payment caps limit how much a student pays by the end of the contract, protecting students from exploitative situations. In practice, this contract term is often expressed as a multiple of the initial funding amount, typically ranging from 1.5 to 2.5 times that of initial funding.<sup>16</sup> The approach that the ISA Student Protection Act of 2019 takes is to set a maximum "commitment factor," calculated by multiplying the contract's length in years by the income share. The bill also caps the income share at 20%.<sup>17</sup> Because payment caps also limit upside opportunity for education providers and investors, they serve as a potentially powerful lever to influence the behavior of market participants.

### Balancing the risk of adverse selection with the benefit of attracting more capital

There is anecdotal evidence that students are averse to high payment caps;<sup>18</sup> students seem to judge the risk of overpaying to be of greater significance than ISAs' downside insurance features—even though this scenario only arises in the case of high earnings. Students may worry that they are “betting against themselves” by entering an arrangement that punishes their success with a higher total repayment.

Because of this dynamic, high payment caps could introduce adverse selection, in which students who are more confident in their earning potential steer clear of ISAs. With fewer “surer bets” in the student pool, investors would offer less favorable contract terms to account for the increase in perceived risk. This plays to fears of Wall Street profiteering, and could stymie the ISA market's growth.

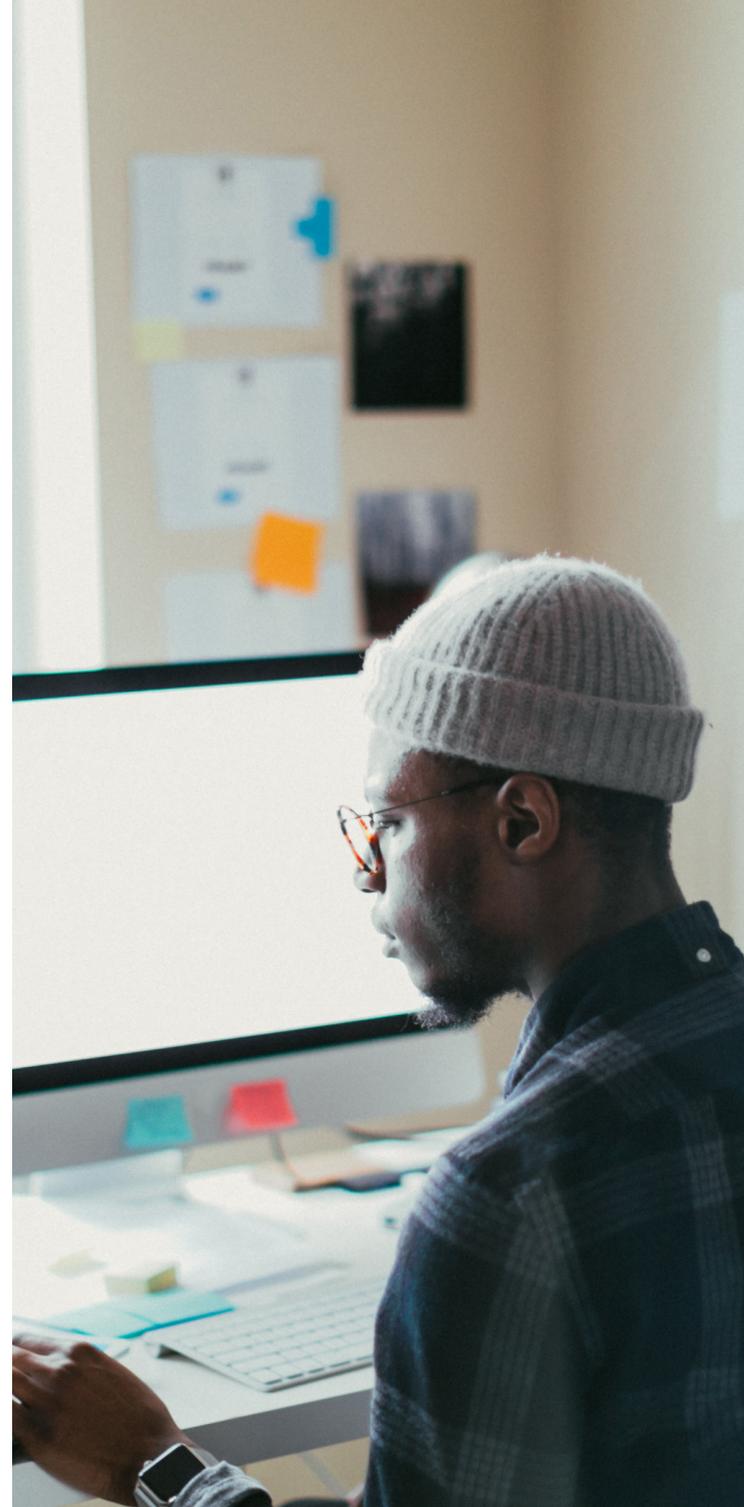
However, from the perspective of education providers and investors, keeping payment caps too low could excessively reduce upside just when the nascent ISA space needs opportunities to generate data and prove itself. A higher payment cap could improve long-term sustainability for ISA programs at colleges, universities, and programs like the San Diego Workforce Partnership, and greater return on investment in the bootcamp space.<sup>19</sup>

### Commonsense approaches that balance student and investor concerns

A common payment cap among coding bootcamps is 1.5 times. Given that as many as 5% of student loan borrowers owe 1.5 times their original loan amount several years into repayment,<sup>20</sup> ISAs with similar or lower payment caps are hardly less fair than student loans. This is especially true given that the student loan borrowers paying the most are those who have struggled the most to make their payments—but with ISAs, it's those who *earn the most* that pay higher amounts.

In traditional institutions, where not all graduates are focused on high-demand fields in tech, the payment cap ranges as high as 2.5 times the initial funding amount. Because of students' strong aversion to high payment caps, market forces will likely keep this contract term in check. That said, legislation that sets a ceiling would prevent predatory practices and providers from entering the space.

A guardrail around payment caps will keep students from paying exorbitant amounts, and could generate solid incentives for capital providers. The commitment factor plus capped income share approach in the current bill does not cap the total payment *amount* for the highest earners like a multiple of initial funding amount would. But it does protect students from punishing combinations of high income share over a long duration, while giving innovators the flexibility to experiment with different ways of setting a cap.



The student loan borrowers paying the most are those who have struggled the most to make their payments—but with ISAs, it's those who *earn the most* that pay higher amounts.

### Guardrail #3: Definitions and disclosures

The lack of a legal definition for ISAs creates uncertainty for those looking to implement this new financing model. Also unclear is the extent to which federal laws, including, but not limited to, the Truth in Lending Act and the Equal Credit Opportunity Act, apply to ISAs—as well as how ISAs should be treated for tax purposes.

Introducing a concrete definition, as recently proposed legislation does, would legitimize the ISA market, provide clarity around how existing regulations apply to ISAs, and assuage consumer fears. Such a definition would also bring to bear on the ISA market the crucial nondiscrimination policies that apply to the student loan and other consumer credit markets.

Importantly, recently proposed legislation includes robust financial disclosure guidelines for ISAs. Disclosure is important for any financial market. As a financial instrument, ISAs should have explicit disclosure requirements, much as other consumer credit markets do.

Higher education markets, in particular, require clear disclosure guidelines, given their complexity and long time horizon. A lack of guidelines leaves room for misunderstandings and even misleading practices.<sup>21</sup> While ISA providers have sought to establish best practices on their own, in order to build trust in an uncertain market, legislators should introduce guidelines to preclude unethical behavior.

The structure of ISAs makes possible a range of total repayment outcomes, which could be higher or lower than would occur under available loan products. ISA disclosures should include a forecast of payment outcomes for different income amounts, including when below the minimum income threshold, when above levels that bring the payment cap into play, and scenarios in between. They should also provide side-by-side comparisons to relevant loan products, allowing students to compare both monthly payments and total payment amounts.

Given that ISA durations can be variable, depending on how providers account for periods of time when income falls below the minimum threshold, ISA disclosure guidelines should include an obligation to make clear the various factors that could lead to payment deferrals. Legislation should also clarify the terms and treatment for students who want to pay their contracts early.

Basic rules of the road that are incorporated into current legislation include clarifying ISA standing under consumer protection laws, credit reporting laws, bankruptcy laws, and income tax provisions for both students and investors. Market participants will benefit from legal clarity on these items.

## WHERE NOT TO LEGISLATE

While some guardrails are crucial at this early stage of the ISA market, legislation should also leave room for experimentation. Innovators are still working out which scenarios are most suitable for ISAs, and how these contracts should look in different contexts to best increase access while generating value for students.

For example, Potsdam, NY-based Clarkson University, which launched its ISA program at the end of 2017, makes ISAs available all four years, with students of a given cohort paying the same income share. In contrast, students at Purdue can only leverage the Back-a-Boiler program starting their sophomore year, with income share varying based on degree program. Even more experimentation is occurring at coding bootcamps, which typically originate ISAs using outside capital, and have tested a range of different financing structures. As innovators iterate toward the most effective arrangements, regulators should consider incentivizing emerging best practices.





## CONCLUSION

In passing ISA legislation, policymakers have an opportunity to strengthen the American higher education system on multiple fronts.

First, thoughtful legislation will ensure that students do not bear the full risk of paying for educational programs that may yield poor workforce outcomes. By setting up guardrails such as minimum income thresholds, limits to how much a student can pay, and disclosure guidelines, policymakers will enable a financing model that ensures strong consumer protections for students.

These same guardrails align the incentives of education providers and other market participants with those of students. This incentive alignment can have a powerful impact on education providers' business models, encouraging innovations that improve students' chances of finding good jobs. It could also catalyze important conversations around what metrics matter most and reshape the competitive landscape to revolve less around prestige and more around learning and labor market outcomes.

Finally, creating clarity around the legal definition of ISAs and how they are treated for tax purposes will invite more widespread adoption of these financing models and increased investment into the ISA market. More capital means greater access, especially for students who are unable to tap into Title IV funds.

Higher education can create immeasurable value for students—when it isn't financially crippling them for decades. The student loan market helps millions of students to make progress in their lives, but the higher education financing system could use another tool to address the needs of those for whom existing solutions aren't working. We welcome ISAs as just such an innovative addition to the toolbox, and encourage Congress to do the same.

# INCOME SHARE AGREEMENTS 101

## THE TRADITIONAL FUNDING MODEL IS FAILING STUDENTS

**\$1.6 TRILLION**

Outstanding student loan debt

**1 MILLION**

Student loan defaults annually



**44%**

Of recent college graduates are underemployed

**57%**

Six-year college completion rate

**21%**

Six-year college completion rate for first-generation, low-income students



**37%**

Employers who think students are well prepared for the workforce

## INCOME SHARE AGREEMENTS CAN:



Shift financial risk away from students



Align program incentives with student outcomes



Increase access for students

## CONGRESS CAN UNLOCK THE POTENTIAL OF THE ISA MARKET WITH GUARDRAILS



### Guardrail #1:

Set mandatory minimum income thresholds, below which students are exempt from making payments on their ISAs.



### Guardrail #2:

Set upper limits on what ISA providers can charge students.



### Guardrail #3:

Establish legal definitions and clear rules of the road as to how ISAs fit into the existing tax, consumer protection, credit reporting, and bankruptcy frameworks.

# NOTES

1. Kristin Blagg, “Underwater on Student Debt: Understanding Consumer Credit and Student Loan Default,” Urban Institute, August 13, 2018, <https://www.urban.org/research/publication/underwater-student-debt>.
2. See Michael B. Horn and Alana Dunagan, “Change the Rules to Unleash Innovation,” *EducationNext* 18 no. 4 (Fall 2018), <https://www.educationnext.org/change-rules-unleash-innovation-forum-rethinking-rules-federal-higher-ed-spending/>.
3. The Morrill Act expanded the higher education system itself in the 1860s by providing land grants to states to found colleges. The G.I. Bill, crafted after World War II to help returning soldiers continue their education and integrate back into the workforce, roughly doubled the number of college enrollments during the 1940s. The Higher Education Act of 1965 and its various reauthorizations created the current funding framework, known as Title IV, making available low-interest loans and expanding federal financial aid to help more students afford a college education.
4. ISA Student Protection Act of 2019, S. 2114, 116th Congress, <https://www.govtrack.us/congress/bills/116/s2114/text>.
5. “What is an ISA?” Lambda School (website), accessed July 27, 2019, <https://lambdaschool.com/isa>. See also Richard Price, “Innovators Worth Watching: Lambda School,” Clayton Christensen Institute, April 3, 2018, <https://www.christenseninstitute.org/blog/innovators-worth-watching-lambda-school/>.
6. Observers expect the market to continue to expand. See Emily Wilkins, “Safeguards Sought for Income-Share Substitute for Student Loans,” *Bloomberg Government*, June 20, 2019, <https://about.bgov.com/news/safeguards-sought-for-income-share-substitute-for-student-loans/>.
7. Michael Horn, “Here’s How ‘Renewable Learning Funds’ Can Transform Workforce Development,” *Forbes*, December 13, 2017, <https://www.forbes.com/sites/michaelhorn/2019/06/20/as-income-share-agreement-politics-heat-up-san-diego-debuts-first-renewable-learning-fund/#333749044fb9>.
8. All values as of 2019/20 academic year.
9. Students can also defer payments for up to 60 months, pausing their contracts under circumstances such as returning to school. Unemployment or making under the minimum income threshold does not pause the contract. Students just owe \$0 for that month. On average, contracts might last about 8 to 10 years when factoring in deferments.
10. Lambda School is also piloting its Living Stipend program, in which students receive \$2,000 per month, for a total of \$18,000, to cover expenses. Students pay this back in an ISA whose terms replace the standard ones. The new terms are 10% of income for 60 monthly payments, with a payment cap of \$50,000.
11. For the median worker, college pays off: as of the second quarter of 2019, median weekly wages for bachelor’s degree holders were \$1,236, versus \$751 for those with only a high school diploma—a nearly 65% increase. But some college degree holders make far less—the bottom tenth percentile wage for bachelor’s degree holders was only \$607 per week. And some who forgo college make far more—the top tenth percentile wage for high school graduates was \$1,521. See Bureau of Labor Statistics, “Usual Weekly Earnings of Wage and Salary Workers Second Quarter 2019,” July 17, 2019, table 5, <https://www.bls.gov/news.release/pdf/wkyeng.pdf>.
12. The student loan system offers income-based repayment plans (IBR), which also track income. That said, students enrolled in IBR plans still have to pay down a fixed principal amount. If their income drops, lowering monthly payments, they accumulate a higher interest balance over a longer repayment period.
13. To access this handbook, or simply to verify its size, see <https://ifap.ed.gov/fsahandbook/1718FSAHbkActiveIndex.html>.
14. Bureau of Labor Statistics, “Usual Weekly Earnings.”
15. The ISA Student Protection Act of 2019 includes this minimum income threshold index. ISA Student Protection Act of 2019, S. 2114, 116th Congress, <https://www.govtrack.us/congress/bills/116/s2114/text>.

16. One notable exception is the ISA program at Colorado Mountain College, where DACA students don't pay more than they take out.

17. Note the importance of capping the income share. Under the commitment factor provision alone, programs with durations shorter than 11.25 years could set their income shares over 20% and still have the commitment factor be at most 2.25 (11.25 years x 0.20 income share = 2.25), the limit set in the bill. Capping the income share at 20% keeps these shorter programs from taking too big a chunk of student salaries. See ISA Student Protection Act of 2019.

18. See Alexander Holt, "Student and Parent Perspective on Higher Education Financing: Findings from Focus Groups on Income-Share Agreements," American Enterprise Institute, December 2016, <https://www.aei.org/publication/student-and-parent-perspectives-on-higher-education-financing/>.

19. The best version of this would result in ISA programs more willing to take a chance on students who might otherwise be expected to have poorer outcomes. The flipside is that capital providers could take on a venture capital mindset, looking more for moonshots than consistent results for all students.

20. The Consumer Financial Protection Bureau (CFPB) Office of Research, "CFPB Data Point: Student Loan Repayment," August 2017, figure 2, page 14. [https://files.consumerfinance.gov/f/documents/201708\\_cfpb\\_data-point\\_student-loan-repayment.pdf](https://files.consumerfinance.gov/f/documents/201708_cfpb_data-point_student-loan-repayment.pdf).

21. The education marketplace is rife with consumer disclosure issues; for instance, concerns have been raised about the vagueness of many colleges' and universities' financial aid award letters. See Stephen Burd et al., "Decoding the Cost of College: The Case for Transparent Financial Aid Award Letters," New America Foundation, June 5, 2018, <https://www.newamerica.org/education-policy/policy-papers/decoding-cost-college/>.

## About the Institute

The Clayton Christensen Institute for Disruptive Innovation is a nonprofit, nonpartisan think tank dedicated to improving the world through Disruptive Innovation. Founded on the theories of Harvard professor Clayton M. Christensen, the Institute offers a unique framework for understanding many of society's most pressing problems. Its mission is ambitious but clear: work to shape and elevate the conversation surrounding these issues through rigorous research and public outreach.

## About the Authors



Richard Price is a research fellow at the Christensen Institute where he focuses primarily on researching how new and innovative models can reshape higher education. Richard's work delves into some of the most pressing topics in higher education today, including policy initiatives, alternative financing mechanisms, and innovative business models.



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