

Issue Brief:

CAN STUDENT-CENTERED INCOME SHARE AGREEMENTS IMPROVE ECONOMIC OPPORTUNITY AND EQUITY?



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INTRODUCTION

As the economy and jobs change, postsecondary education and training can support workers to learn new skills and seek new opportunities in the labor market.

Workers seeking postsecondary training currently have few good options. Employers provide limited opportunities for workers to acquire new skills, particularly for frontline workers and workers of color.¹ Public investments in postsecondary education and training are also limited, especially as states experience significant budget shortfalls.² Finally, “alternative training providers” such as vocational schools, academies, and bootcamps provide short-term skills training, but they can be expensive, have varying levels of quality (which we define throughout this report as measured by earnings and employment outcomes), and are inconsistently regulated.

Over the last five years, income share agreements (ISAs) have emerged as an option for students to finance education and training.³ Unlike a traditional loan, students pay a fixed percentage (“payment rate,” also often referred to as the “income share”) of their income over a defined period, and students earning below a specified threshold make no payment. The financial obligation ends once the student makes a certain number of payments or a specified period of time elapses, regardless of how much they have paid. Many ISA contracts also end if a student’s total payments have reached a specified cap, often expressed as a multiple of the amount he or she initially financed with the ISA. As of late 2019, over 40 U.S. colleges and universities and numerous alternative training providers have offered ISAs to finance education, and new programs are continuing to emerge.⁴

This emergence has alarmed many consumer advocates and other higher education experts who have expressed deep concern that students using ISAs could be vulnerable to complex financial terms, misleading marketing, aggressive collection practices, low-quality and possibly predatory education, and that such education financing could exacerbate racial, gender, and economic inequities.

As schools and other organizations interested in expanding access to education finance (hereafter referred to as “ISA providers”) are experimenting with a variety of ISA approaches, this developmental stage offers an opportunity to guide the design of ISAs—and the business models that support them—toward a student-centered approach. This report provides an overview of the range of providers using ISAs, examines the potential benefits and key risks and concerns related to ISAs, and concludes by suggesting how policymakers and ISA providers can protect students and center ISAs around student interests.

- 1 Osterman, Paul. 2020. “Skill Training for Adults.” MIT Work of the Future. October. <https://workofthefuture.mit.edu/research-post/skill-training-for-adults/>.
- 2 Gillers, Heather, and Gunjan Banerji. 2020. “U.S. States Face Biggest Cash Crisis Since the Great Depression.” *Wall Street Journal*. October 28. <https://www.wsj.com/articles/u-s-states-face-biggest-cash-crisis-since-the-great-depression-11603910750>
- 3 Though less common, some ISAs are being offered outside of the context of education. While this report focuses on education ISAs, these “direct to consumer” ISAs share many of the same consumer protection and equity risks as education ISAs and fewer potential benefits.
- 4 Ritter, Dubravka, and Douglas Webber. 2019. “Modern Income-Share Agreements in Postsecondary Education: Features, Theory, Applications.” Federal Reserve Bank of Philadelphia. December. <https://www.philadelphiafed.org/consumer-finance/education-finance/modern-income-share-agreements-in-postsecondary-education-features-theory-applications>.

Research Approach

This report is the culmination of a year-long research project conducted by the Aspen Institute Future of Work Initiative to explore how ISAs could be designed and operated to improve economic opportunity for American workers. Seeking opportunities for stakeholders with diverse viewpoints about ISAs to deliberate and seek consensus, the Initiative conducted nearly 40 formal interviews with stakeholders across the ISA landscape, including non-profit, for-profit, and workforce ISA providers; impact investors; philanthropic organizations; consumer protection advocates; workforce experts; and higher education policy experts.⁵ The Initiative then organized a small

group of practitioners and policy professionals to discuss policy guardrails and student-centered ISA principles over the course of two roundtable discussions. Finally, the Initiative invited experts whose work has focused on the risks that ISAs pose to students, their impact on racial and gender equity, and ISAs' role in the broader higher education financing system to join a larger convening in the fall of 2020. Throughout this process, the Aspen Institute Economic Opportunities Program played an advisory role in this project, drawing on its extensive work related to strategies to help low-income adult learners earn credentials and connect to good jobs.

Summary of Policy Guidance & Principles for Student-Centered ISAs

GUIDANCE TO POLICYMAKERS

Strong policy guardrails around the design and operation of ISAs can help ensure that students are better protected, and that ISAs align with their interests.

1. Ensure existing federal and state consumer credit protections are appropriately applied to ISAs
2. Consider new protections uniquely designed for ISAs

PRINCIPLES FOR PROVIDERS

Principles can help ISA providers, as well as investors and philanthropic organizations that work with providers, understand how to design and operate ISAs to protect and center students' interests.

1. ISA providers should ensure students understand what they are signing up for
2. ISA providers should design ISAs so that all students can make payments and afford basic living costs
3. ISA providers and their investors should bear most of the risk of poor economic outcomes
4. ISA schools should provide information on education and employment programs outcomes to the public
5. ISA providers should work to reduce existing racial and gender disparities
6. ISA providers should carefully choose their investors and design their financial arrangements to avoid undermining the alignment between the provider's financial incentives and students' performance
7. ISA providers should encourage students to explore all available federal financial aid options prior to entering into ISA contracts
8. ISA providers should collect and consider student and former student input when designing and improving ISA terms
9. ISA providers should strive to be consistent with existing federal and state laws governing traditional loans

⁵ This report uses the term "ISA provider" to refer to the entity entering into a contract with the student. ISA providers are often schools, but some are third parties that may have formalized relationships with schools.

INCOME SHARE AGREEMENT MODELS

There is a diversity of ISA providers, including for-profit investors and schools, philanthropic programs, and quasi-governmental workforce training entities. These groups often have varying reasons for using ISAs that relate to the specific context within which their programs operate, the students they are serving, and whether they are mission-driven, profit-seeking, or both.

Below are three basic categorizations of ISA models, largely based on a framework developed by Dubravka Ritter and Douglas Webber at the Federal Reserve Bank of Philadelphia in 2019⁶:

- **Yield-based models** are ISAs funded by an investor looking for a return on capital. The school itself could be for-profit or nonprofit. Examples include Purdue University's Back a Boiler ISA, General Assembly's Catalyst Program, and a variety of other for-profit bootcamps, academies, and vocational schools.
- **Evergreen models** are ISAs often used for philanthropic purposes that aim to recycle ISA student payments back into the fund for future cohorts of students, with a goal of becoming self-funding over time. Examples include San Diego Workforce Partnership's Income Share Agreement Fund, the University of Utah's Invest in U, and New York City's Talent Financing Fund.⁷ Recently announced initiatives such as Robert Smith's HBCU Student Freedom Initiative and the New Jersey CEO Council's Career Impact Bond Fund are also described as evergreen funds.⁸
- **Deferred tuition models** are ISAs used to stretch—but not fully recover—philanthropic funding over time. Colorado Mountain College's Fund Sueños is an example.

Within each category, institutions may each have unique reasons for using ISAs. Purdue University uses its ISA program largely to provide gap funding for students who have exhausted their eligibility for the more favorable Stafford loans and are interested in an alternative to Parent PLUS or private student loans. Bootcamps, academies, and vocational schools may use ISAs as a way to signal school quality and financial alignment to prospective students, as well as to ensure students have access to financing in the absence of federal financial aid. The University of Utah uses its ISA program to help its student population avoid traditional debt without resorting to reducing credit hours or dropping out entirely.⁹ Colorado Mountain College uses its ISA program to extend funding to undocumented students who are ineligible for federal aid.

POTENTIAL BENEFITS OF ISAS

Proponents of ISAs note their potential to address four separate yet interlocking problems associated with postsecondary education and training.

School Quality. ISAs could encourage school quality by aligning student tuition payments with post-graduation earnings and employment outcomes.

6 Ritter, Dubravka, and Douglas Webber. 2019. "Modern Income-Share Agreements in Postsecondary Education: Features, Theory, Applications." Federal Reserve Bank of Philadelphia. December. <https://www.philadelphiafed.org/consumer-finance/education-finance/modern-income-share-agreements-in-postsecondary-education-features-theory-applications>.

7 San Diego Workforce Partnership. "Workforce Income Share Agreement Fund." <https://workforce.org/isa/>.

The University of Utah. "Income Share Agreement: How to Get Money." <https://isa.utah.edu/how-to-get-money/>.

New York City Economic Development Corporation. 2019. "Exploring Income Share Agreements." *Medium*. November. <https://medium.com/@NYCEDC/exploring-income-share-agreements-f5fa802314ad>.

8 Whitford, Emma. 2020. "Billionaire Robert Smith Announces New ISA for HBCUs." *Inside Higher Ed*. June 25. <https://www.insidehighered.com/quicktakes/2020/06/25/billionaire-robert-smith-announces-new-isa-hbcus>.

Office of New Jersey Governor Phil Murphy. 2020. "Coalition of New Jersey CEOs Aim to Hire or Train 70,000 New Jersey Residents by 2030, Increase Local Spending by \$500 million by 2025." October. <https://www.nj.gov/governor/news/news/562020/20201015a.shtml>.

9 Mumford, Jacqueline. 2019. "University of Utah Begins Offering Income Share Agreements for 18 Majors." *Daily Utah Chronicle*. April 16. <https://dailyutahchronicle.com/2019/04/16/university-of-utah-begins-offering-income-share-agreements-for-18-majors/>.

Affordability. ISAs could help ensure education is affordable for students by timing tuition payments to better match students' ability to pay, which could be particularly helpful to students with low initial earnings or those who face income volatility, and by requiring lower payments from lower-earning students.

Access to Education. ISAs have the potential to improve access to education by extending financing to students who either have exhausted traditional loan options, do not qualify for existing federal aid options (e.g. undocumented students, students seeking to attend non-title IV schools such as workforce training programs), or are particularly debt-averse.¹⁰

Racial and Economic Equity. While long-standing racial and economic inequities are attributed to far more than just educational access and attainment, ISAs could help reduce these inequities as they relate to postsecondary education access. An estimated 45 million consumers—roughly 20 percent of the U.S. adult population—may be denied access to credit because they lack a credit history that can be scored, which disproportionately impacts Black and Hispanic consumers.¹¹ Consumers with poor credit, or whose parents' income or credit history precludes them from co-signing a private loan or taking out a Parent PLUS loan, may also face obstacles in accessing credit to pay for education. ISAs' focus on students' expected future success rather than past metrics like income and credit score could expand access to financing and thus access to educational and job opportunities.¹²

RISKS & CONCERNS

Consumer advocates and higher education experts have expressed serious concerns about the risks that ISAs could potentially pose to students, their role in the largely unaccredited alternative training market, and their impact on racial and gender equity.¹³ Some ISA providers share these concerns, and worry that failing to address them will leave the market vulnerable to inequitable or even predatory practices. Given that ISAs are relatively new and currently occupy a small market share, some of these concerns are speculative or informed by similar observed issues in consumer credit and student loan markets. The following section is a summary of these key risks and concerns.

Consumer Protection

Understanding ISA Terms. ISA contracts may be difficult to fully understand. Students already struggle to understand existing financial products, and ISAs are a relatively new product, with little consistency in terminology across contracts. Students could therefore enter into contracts without fully understanding that they may be required to forgo a portion of their income for extended periods of time, and that this time period could be lengthened if students fall below the income threshold. It may also be difficult

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- 10 Boatman, Angela, Brent J. Evans, and Adela Soliz. 2017. "Understanding Loan Aversion in Education: Evidence from High School Seniors, Community College Students, and Adults." *AERA Open* 3, no. 1. (January-March): 1-16. <https://journals.sagepub.com/doi/full/10.1177/2332858416683649>.
- Khan, Tasmiha. 2019. "The American Student Loan System Is Not Muslim-Friendly." *Vice*. May 29. https://www.vice.com/en_us/article/nea4b8/the-american-student-loan-system-is-not-muslim-friendly.
- Smardon, Andrea. 2018. "Degrees Without Debt." *U.S. News & World Report*. May 3. <https://www.usnews.com/news/best-states/articles/2018-05-03/in-utah-many-college-students-graduate-without-debt>.
- 11 Consumer Financial Protection Bureau. 2016. "Who are the credit invisibles? How to help people with limited credit histories." December. <https://www.consumerfinance.gov/data-research/research-reports/who-are-credit-invisibles/>. This report uses racial/ethnic categories that align with the categories used by the individual data sources.
- 12 Meschede, Tatjana, Joanna Taylor, Alexis Mann, and Thomas Shapiro. 2017. "Family Achievements?: How a College Degree Accumulates Wealth for Whites and Not For Blacks." *Federal Reserve Bank of St. Louis Review* 99, no. 1. (First Quarter): 121-37. <https://files.stlouisfed.org/files/htdocs/publications/review/2017-02-15/family-achievements-how-a-college-degree-accumulates-wealth-for-whites-and-not-for-blacks.pdf>.
- 13 "Pearl, Joanna, and Brian Shearer. 2020. "Credit By any Other Name: How Federal Consumer Financial Law Governs Income Share Agreements." Student Borrower Protection Center. July. <https://protectborrowers.org/credit-by-any-other-name-how-federal-consumer-financial-law-governs-income-share-agreements/>.
- Hayes, Stephen, and Alexa Milton. 2020. "Solving Student Debt or Compounding the Crisis? Income Share Agreements and Fair Lending Risks." Student Borrower Protection Center. July. <https://protectborrowers.org/solving-student-debt-or-compounding-the-crisis-income-share-agreements-fair-lending-risks/>.
- Habash, Tariq, Joanna K. Darcus, and Julie Margetta Morgan. 2019. "Will Income-Share Agreements Be the Next Payday Loans?" *The American Prospect*. July. <https://prospect.org/education/will-income-share-agreements-next-payday-loans/>.
- Mishory, Jen. 2019. "Private ISA Student Loans Highlight Consumer Protection Challenges." *The Century Foundation*. August. <https://tcf.org/content/commentary/private-isa-student-loans-highlight-consumer-protection-challenges/>.

to understand that they may need to make payments even if they get a job in a different field, the consequences of failing to comply with provisions like income recertification, and the potential debt collection practices.

Understanding Potential Payment Scenarios. ISAs may be difficult for students to evaluate because the payments are contingent on their future incomes. While there is some variation in how much a student pays back in a traditional loan, the range of scenarios for ISAs is generally much larger. While ISA providers often disclose how much a student would pay under various income scenarios, it can be difficult for a student to anticipate the scenario that may eventually apply to them.

Comparing Options. Traditional loans use standardized disclosures, including annual percentage rate (APR), to help students and other consumers compare loans. ISA providers tend to present payment amounts in each income scenario in dollar terms, making it difficult for students to compare ISAs to traditional loan options. This format of disclosure is also not standardized across providers.

Marketing. ISA marketing materials may include the claims “not a loan” and “zero interest.” This marketing may also give students a false sense of security, leading students to fail to closely scrutinize the ISA and the risks the terms present.

Affordability and Overleveraging. ISAs require students to pay a fixed proportion of their income if it exceeds a certain threshold, but this does not guarantee that ISAs are affordable. For instance, income thresholds may be set too low if not based on a living wage. Students who make just above the income threshold may also find ISA payments unaffordable because they must pay a percentage of their entire income rather than a percentage of their income above the threshold, leaving them with less-than-expected income for essential costs like housing and food. ISAs generally use individual earnings to determine monthly payment amounts and do not account for household size, which could lead payment rates to be untenable for an individual with multiple dependents (this is also true for private student loans and some federal loans). Finally, an ISA that is layered on top of other ISAs, traditional student loans, or other forms of credit could render a student's total monthly payments on all financial obligations unaffordable.

Collection Practices. ISA students are potentially vulnerable to many of the same collection practices that exist for traditional private student loans, such as inadequate notice of lawsuits and requiring automatic bank account withdrawals and payroll withholding.¹⁴ In addition, students are vulnerable to collection practices that are unique to ISAs or particularly onerous in ISA contracts, such as acceleration clauses that allow ISA providers to collect more than the amount financed (often multiples of the amount financed) in the event of non-filing or nonpayment of amounts owed.¹⁵ In addition, mandatory arbitration clauses in ISA contracts can prevent students from effectively defending themselves against these practices.¹⁶

Education Quality & Cost

Education Quality. Concerns regarding postsecondary education quality, specifically regarding alternative training providers, are longstanding and predate ISAs. While ISAs have the potential to incentivize programming that drives strong employment and earnings outcomes, this is not always the case. Just as predatory payday lenders can profit on defaulting consumers, it is possible for predatory ISA programs—or even simply poorly-designed ISAs—to profit even as the student struggles. In fact, there are concerns that ISAs may exacerbate this problem precisely because their marketing often assures students that the school only succeeds if the student does. This could give students a false sense of security and consequently make them less skeptical of the school's claims.

¹⁴ National Consumer Law Center. “What States Can Do to Protect Consumers: Student Loans.” <https://www.nclc.org/issues/fs-student-loans.html>.

¹⁵ Ritter, Dubravka, and Douglas Webber. 2019. “Modern Income-Share Agreements in Postsecondary Education: Features, Theory, Applications.” Federal Reserve Bank of Philadelphia. December. <https://www.philadelphiafed.org/consumer-finance/education-finance/modern-income-share-agreements-in-postsecondary-education-features-theory-applications>.

¹⁶ These clauses do tend to allow students to opt-out of mandatory arbitration at the time of signing the contract or soon after, but consumer advocates note that few students opt-out or are even aware of the option.

Risk Offloading: If ISA providers securitize and sell their ISA contracts to third parties, they may no longer feel they have a stake in their students' labor market outcomes. In this case, short-term incentives may no longer align for schools to maintain education quality or placement services.

Tuition Inflation: While schools are required to post the tuition amount being financed, students may focus more on the terms of the ISA. As a consequence, students with ISAs may be less sensitive to tuition prices, and the complexity of the ISA could allow schools to opaquely raise tuition prices or resist pressures to lower tuition prices.

Investor Pressures: Risks related to education quality and tuition inflation could be exacerbated by pressures from investors to reduce costs or increase profits, especially those who are not mission-driven. Depending on the structure of the financial relationship, schools may feel pressure from their investors to boost enrollment, cut enrollment among students perceived as higher risk, or cut costs rather than improve quality.

Equity

Reverse redlining is where a predatory product targets a protected class, thus causing that class disproportionate harm. In other words, failing to address the concerns in the Consumer Protection and Education Quality & Cost sections above could not only lead to predatory products that harm students, but could also exacerbate racial, gender, and economic disparities if the ISA targets protected classes through marketing or other means. There is a long history of predatory for-profit schools and predatory lending practices disproportionately harming Black and Hispanic students.¹⁷ Research suggests that ISAs—particularly the fact that they're not marketed as loans—may have unique appeal to Black and Hispanic students, so an ill-designed ISA that does not intentionally target vulnerable populations may still cause disproportionate harm.¹⁸

Disparate impact occurs when facially neutral policies or practices have a disproportionately adverse effect on a protected class and are otherwise unjustified by a legitimate rationale. For instance, if ISA providers charge higher rates and longer payment lengths to students in lower-earning fields of study ("differential pricing"), and if these fields of study have high concentrations of racial minorities, women, or students from lower-income backgrounds, these ISAs could exacerbate racial, gender, and economic disparities.¹⁹

For example, Stride Funding bases its ISA pricing on the specific school the student is attending, while Purdue University and University of Utah base theirs on the student's field of study. Researchers at the Student Borrower Protection Center analyzed sample private student loan rate quotes from lenders who use categorical variables to offer differentially-priced loans and found that borrowers who attended community colleges, Historically Black Colleges and Universities (HBCUs), and Hispanic-Serving Institutions (HSIs) were offered significantly more expensive loans.²⁰ ISA providers following this practice may be producing a similar impact.

Consumer advocates argue that it is ISA providers' usage of categorical variables, like field of study, that might violate the law. Traditional risk-adjustment variables, like income and credit score, treat students as individuals rather than as members of groups and are therefore more likely to be legal.

17 Body, Dyvonne. 2019. "Worse Off Than When They Enrolled: The Consequence of For-Profit Colleges for People of Color." Aspen Institute Financial Security Program. March. <https://www.aspeninstitute.org/blog-posts/worse-off-than-when-they-enrolled-the-consequence-of-for-profit-colleges-for-people-of-color/>.

Mishory, Jen, Mark Huelsman, and Suzanne Kahn. 2019. "How Student Debt and the Racial Wealth Gap Reinforce Each Other." The Century Foundation. September. <https://tcf.org/content/report/bridging-progressive-policy-debates-student-debt-racial-wealth-gap-reinforce/>.

18 Evans, Brent J., Angela Boatman, and Adela Soliz. 2019. "Framing and Labeling Effects in Preferences for Borrowing for College: An Experimental Analysis." *Research in Higher Education* 60, no. 4 (2019): 438-457. <https://www.cuny.edu/wp-content/uploads/sites/4/page-assets/about/administration/offices/oira/policy/seminars/Framing-and-Labeling-Effects-in-Preferences-for-Borrowing-for-College-An-Experimental-Analysis.pdf>.

19 Hayes, Stephen, and Alexa Milton. 2020. "Solving Student Debt or Compounding the Crisis? Income Share Agreements and Fair Lending Risks." Student Borrower Protection Center. July. <https://protectborrowers.org/solving-student-debt-or-compounding-the-crisis-income-share-agreements-fair-lending-risks/>.

20 Student Borrower Protection Center. 2020. "Educational Redlining." February. <https://protectborrowers.org/wp-content/uploads/2020/02/Education-Redlining-Report.pdf>.

Broader equity concerns are important to raise beyond the specific disparate impact legal theory. Differential pricing is far less common among alternative training providers like Holberton School, Lambda School, Flatiron School, and Kenzie Academy which offer uniform ISA terms to all their students. Yet there are still significant equity concerns in this market. If a school with disproportionately female and students of color offered a uniform ISA with less favorable terms than a largely white and male school, this would still exacerbate racial and gender disparities in a way that is emergent from the market rather than connected to individual providers' actions, but no less harmful to the broader goals of equity.

It should also be noted that this problem is not necessarily unique to ISAs—the usage of backward-looking individualized variables to price traditional private loans also exacerbates equity disparities by compounding the structural discrimination that protected classes have faced over the course of their lives. ISA providers believe that by instead using forward-looking variables (and therefore categorical variables by necessity), they can have a more positive effect on equity than traditional lending practices. Whether they are correct or not is an open empirical question, but the law is clearly more established on the first approach than the second.

GUIDANCE TO POLICYMAKERS

Many of the aforementioned risks and concerns regarding ISAs can be addressed with strong policy guardrails around the design and operation of ISAs, which can help ensure that students are better protected and that ISAs align with their interests. This section highlights two approaches policymakers can consider.

Ensure Existing Federal and State Consumer Credit Protections Are Appropriately Applied to ISAs

Much of the debate around consumer protections centers on whether ISAs are subject to existing consumer credit protections, which include ensuring transparent and standardized contract terms, providing antidiscrimination protections, and regulating collection practices and debt reporting. Consumer advocates argue that an ISA is simply a loan with a different name and therefore subject to the same consumer credit protections as any other traditional loan.²¹ Meanwhile, many in the ISA industry typically argue that an ISA is a new financial product that should be treated by regulators as not subject to most existing credit protections.²² This legal question is important for federal and state regulators to consider as they determine how to apply existing law, but it is beyond the scope of this report.

In contrast, there appears to be some agreement that ISAs should be subject to those same protections. For those who share the legal interpretation that ISAs are already subject to these protections, this could be achieved through relevant regulators publicly clarifying that they believe ISAs are under their purview and providing guidance on how ISA providers can comply with existing law. For those who share the legal interpretation that ISAs are not currently subject to these protections, this could be achieved by updating the definition of credit in each protection to explicitly include ISAs.

21 This includes the Equal Credit Opportunity Act, Fair Credit Reporting Act, Fair Debt Collection Practices Act, Truth in Lending Act, Military Lending Act, Servicemembers Civil Relief Act, Holder Rule, and other relevant statutes. Pearl, Joanna, and Brian Shearer. 2020. "Credit By any Other Name: How Federal Consumer Financial Law Governs Income Share Agreements." Student Borrower Protection Center. July. <https://protectborrowers.org/credit-by-any-other-name-how-federal-consumer-financial-law-governs-income-share-agreements/>.

22 For example, Early et al (2019) and Fischer, Mandell, and Moyer (2019) both argue that ISAs are likely not subject to the Truth in Lending Act, Equal Credit Opportunity Act, the Fair Credit Reporting Act, but also that they may be subject to protections with broader definitions of credit, such as the Fair Debt Collection Practices Act, and both Unfair, Deceptive and Abusive Acts and Practices (enforced by the Consumer Financial Protection Bureau) and Unfair or Deceptive Acts or Practices (enforced by the Federal Trade Commission). Yet both stress that courts have not made definitive rulings one way or the other, therefore ISA providers should proceed with caution. Earley, Maria B., and Robert E. Goldenberg. 2019. "Income Share Agreements: How They Work and Their Place in the Federal Regulatory Regime." Reed Smith. September. <https://www.reedsmith.com/en/perspectives/2019/09/income-share-agreements-how-they-work-and-their-place>. Morrison Foerster. 2019. "Regulatory Treatment of Educational Isas Under Federal and Select State Consumer Credit Statutes." March. <https://www.mofo.com/resources/insights/190408-regulatory-educational-consumer-credit-statutes.html>.

But simply ensuring that existing protections apply to ISAs without considering how they should apply to ISAs could leave students inadequately protected or deprived of access to any ISA financing. ISAs do appear to have unique features (no principal, highly variable payment amounts, etc.) that policymakers and regulators must take into account—either through guidance or new legislation—to ensure students are truly protected. Below is a discussion of how two key federal credit protections—the Truth in Lending Act (TILA) and the Equal Credit Opportunity Act (ECOA)—could be applied to ISAs.

Truth in Lending Act: The purpose of TILA is to ensure consumers understand the terms of credit products and to help them comparison shop between different products. TILA requires standardized terms and disclosures in credit contracts, including listing the amount financed, annual percentage rate (APR), finance charge, and total payments.

The APR, which is intended to measure the total cost of the credit to the consumer, is a particularly important feature in helping consumers understand the overall cost and compare across products. But this metric can be a challenge when applied to ISAs, as the total cost of the ISA can vary widely from student to student depending on their future income. As noted in the previous section, some students with ISAs will pay nothing (a negative infinity APR) while others, if they earn a significant income early in the contract, could end up paying back much more than the amount financed in a short amount of time, leading to an extremely high APR.

The Future of Work Initiative’s interviews with stakeholders revealed three potential approaches: (1) disclosing APR based on the school’s median outcome; (2) disclosing the highest possible APR; and (3) disclosing a table of outcome scenarios with APRs. Each of these approaches has its merits and drawbacks.

The Consumer Financial Protection Bureau (CFPB) could study APR disclosure approaches to determine which best informs and protects students, as well as proactively issue guidance on how ISA providers can comply with existing law with standardized ISA terminology and disclosure formats.

Equal Credit Opportunity Act: ECOA is intended to ensure equal access to credit by prohibiting creditors from discriminating against applicants on the basis of a protected class, such as race, color, religion, national origin, sex, marital status, age, or receipt of public assistance. ECOA protects against discriminatory actions where discriminatory intent can be proven. If intent cannot be shown, ECOA may still prohibit certain actions that have a disproportionately adverse effect on protected classes, unless the creditor’s actions are justified by a legitimate business interest which cannot be achieved in another way. For example, charging higher interest—or simply denying credit—to consumers with low credit scores results in less favorable credit terms or less access for Black and Latino consumers.²³ Yet this practice is generally permitted because creditors have a legitimate business interest to assess credit-worthiness, and no court has ruled that there is a clear alternative that accomplishes the same goal while avoiding disparate impact.

The CFPB is responsible for determining whether ISA providers’ practice of differential pricing—that is, charging different rates to students who attend different programs or schools—is a violation of ECOA. While it has not made any determinations for ISA providers, in November 2017 it issued a No-Action Letter to a traditional private loan lender for its usage of education and other alternative data in their underwriting and pricing practices, which also required that the lender provide regular data about the company’s business practices.²⁴ The CFPB could evaluate whether this letter has been effective, and if so signal an openness to a similar arrangement with ISA providers. Moreover, the CFPB could conduct rigorous research into the usage of school and field-of-study variables in lending practices and their impact on racial and gender equity compared to traditional backward-looking individualized data, which could then inform broader industry guidance and potential enforcement actions. Finally, if the CFPB finds reason to believe that ISAs pose a risk to consumers, it could consider extending its

23 Racial Justice and Equal Economic Opportunity Project. 2016. “Past Imperfect: How Credit Scores and Other Analytics “Bake In” and Perpetuate Past Discrimination.” National Consumer Law Center. May. https://www.nclc.org/images/pdf/credit_discrimination/Past_Imperfect050616.pdf. Rice, Lisa, and Deidre Swesnik. 2014. “Discriminatory Effects of Credit Scoring on Communities of Color.” *Suffolk University Law Review* 46. https://cpb-us-e1.wpmucdn.com/sites.suffolk.edu/dist/3/1172/files/2014/01/Rice-Swesnik_Lead.pdf.

24 Consumer Financial Protection Bureau. 2017. “CFPB Announces First No-Action Letter to Upstart Network.” September. <https://www.consumerfinance.gov/about-us/newsroom/cfpb-announces-first-no-action-letter-upstart-network/>.

supervisory authority to ISA providers, which would allow the CFPB to require reports from, and conduct examinations of, providers.²⁵

Consider New Protections Uniquely Designed for ISAs

Ensuring that ISAs are appropriately incorporated into existing law is an important first step, but ISAs also have features that pose unique risks to students. Given this, it is possible that existing law may not provide sufficient protection. If additional protections are needed, policymakers could focus on three areas:

Regulate ISA terms to ensure payments are affordable: A key promise of ISAs is affordability, and policy could take additional steps to help ensure providers fulfill this promise. Approaches could include requiring that the ISA income base exclude non-employment income (e.g. disability and unemployment benefits); setting a maximum payment rate, payment cap, and minimum income threshold informed by student living costs; limiting the length of contracts; protecting against students becoming overleveraged; clarifying that ISAs are dischargeable in bankruptcy; and subjecting ISA providers to broad ability-to-pay requirements.²⁶ Many of these protections could be applied to traditional student loans as well.

Protect students from predatory ISAs: In addition, policymakers could consider requiring greater disclosure of the financial relationship between ISA providers and investors. Further, policymakers could limit acceleration clauses, increase enforcement capacity of collection practices, and restrict marketing practices that lead students to believe ISAs involve limited risk or financial obligation. Moreover, policymakers could consider restricting the use of binding arbitration in ISA contracts so that students may better exercise their rights.

Ensure greater transparency around school outcomes: School quality (defined by employment and earnings outcomes) is a persistent concern across postsecondary education, especially among—though not limited to—schools that are for-profit and lack accreditation recognized by the U.S. Department of Education. But the imperative for outcome transparency is high for ISA schools because students' payment amounts are tied to their outcomes, and ISAs could give students a false sense of security regarding the quality of the school. Policymakers could consider requiring ISA schools to disclose earnings distribution data and ISA payment patterns at multiple percentiles for the length of their ISAs and disaggregate data by race and gender.²⁷ Policymakers could consider applying these types of enhanced outcome data disclosure requirements to non-ISA schools as well, where such data are not already available.

PRINCIPLES FOR PROVIDERS

While application and enforcement of existing consumer protections is urgently important, ISA providers—which may be the school itself or a third-party entity—focused on expanding opportunity for students can adopt voluntary guidance that exceeds this standard. These principles can help ISA providers, as well as investors and philanthropic organizations that work with providers, understand how to design and operate ISAs to protect and center students' interests.

The following principles are intended to balance three separate goals. First, to protect students, in part by ensuring that ISA providers and funders share in the risk of student employment outcomes. Second, to provide broad and equitable access to ISA funding, especially for students who would not otherwise have access to education or who would face gaps in their ability to finance higher education. And finally, to ensure ISA programs' sustainability is driven by successful student outcomes.

25 Consumer Financial Protection Bureau. 2013. "The CFPB Issues Procedural Rule on Supervising Nonbanks that Pose Risks to Consumers." June. <https://www.consumerfinance.gov/about-us/newsroom/the-cfpb-issues-procedural-rule-on-supervising-nonbanks-that-pose-risks-to-consumers/>.

26 Whether ISAs are currently dischargeable in bankruptcy depends on whether they are legally considered a traditional loan or not. Given the regulatory uncertainty, policymakers should consider clarifying that they are dischargeable.

27 Outcome disclosures should include appropriate privacy protections for small populations.

These principles serve as a complement to guidance tailored to specific interventions or sectors on how to construct student-centered programs with ISAs—for example, the San Diego Workforce Partnership, the workforce board for San Diego city and county, has published reference materials to support other workforce development entities in designing ISA programs.²⁸

- 1. ISA providers should ensure students understand what they are signing up for.** Students need clear disclosures that include APR calculations at either the median outcome or in a table of outcome scenarios that includes the minimum and maximum costs to allow students to compare between ISAs and traditional loans. Students should also receive at least a minimal level of financial counseling to enable them to understand the implications of the ISA on their finances, including a comparison tool with alternate financing options.
- 2. ISA providers should design ISAs so that all students can make payments and afford basic living costs.** Providers should take care to set income thresholds above their students' living wage, if such estimates are possible, and might consider adjusting thresholds based on household composition.²⁹ Providers should also act as responsible lenders by evaluating students' existing financial obligations and ability to pay prior to offering an ISA.
- 3. ISA providers and their investors should bear most of the risk of poor economic outcomes.** Long payment windows or excessive extensions of payment windows due to nonpayment of amounts owed or not being in the labor force should be limited, as they shift the risk of earning low income—whether from poor education quality, non-completion, or job market shifts—from the ISA provider and onto the student. Collection practices such as acceleration clauses, which may result in students being charged large sums in the event of non-filing or nonpayment of amounts owed, can also undermine ISAs by shifting risk back onto students. These practices should be limited, and providers should monitor their effects on students.
- 4. ISA schools should provide information on education and employment programs outcomes to the public.** Schools that offer ISAs should publicly disclose summary statistics including prior income, student completion rates, employment rates, wage outcomes, and ISA payment patterns, disaggregated by demographic and with the appropriate privacy protections for small populations.
- 5. ISA providers should work to reduce existing racial and gender disparities.** ISA schools should include breakdowns by race and gender in their publicly disclosed educational outcomes data, and provide anonymized student-level data to reputable third-party researchers to evaluate their outcomes and whether their ISAs are creating disparate impact across racial and gender groups.³⁰ ISA providers that offer differentially-priced ISAs using broad categories like field of study should regularly evaluate how this practice impacts racial and gender equity. Finally, schools and other providers should provide wraparound services (e.g. emergency cash, provision of food, transit, and technology) that address systemic barriers to enrolling, persisting, and succeeding in training.
- 6. ISA providers should carefully choose their investors and design their financial arrangements to avoid undermining the alignment between the provider's financial incentives and students' performance.** Providers should carefully choose their investors, particularly if the prospective investor is seeking market-rate returns, to ensure that each prospective investor is aligned around values and goals. Providers who do accept market-rate investor capital should be careful to avoid entering into a financial agreement that undermines the alignment between the school's financial incentives and the students' performances, and they should publicly disclose the anticipated rate of return that they are communicating to their funders.

28 San Diego Workforce Partnership. "Resources for Outcomes-Focused Funding Models." <https://workforce.org/outcomescenter>.

29 Providers whose customers are geographically concentrated (e.g. schools that provide in-person classes) should set the threshold to avoid ISA payments reducing income to below a living wage. Schools with remote learning and other ISA providers that are not specific to a region could determine living costs based on customer surveys and set the income threshold accordingly.

30 This guideline should not preclude schools with racial equity missions to target protected classes of students, though these schools should be particularly careful that their ISA is aligned with their students' interests.

7. ISA providers should encourage students to explore all available federal financial aid options prior to entering into ISA contracts. Title IV schools should provide financial counseling to students who are interested in a school's ISA to explore their federal financial aid options. If the student is eligible, the school should offer to help them enroll in federal financial aid prior to offering them an ISA. These schools should report data to show whether their usage of ISAs is impacting financial aid participation.

8. ISA providers should collect and consider student and former student input when designing and improving ISA terms. Providers should formally integrate student feedback into the ISA design and counseling process, and regularly revise their ISA design based on student experiences. Special attention should be paid to the experiences of historically marginalized populations.

9. ISA providers should strive to be consistent with existing federal and state laws governing traditional loans. Providers should proactively work with consumer protection experts to craft best practices that comply with the law, and in cases of regulatory uncertainty, approach regulators to seek approval for these practices.

CONCLUSION

ISAs have emerged as an intriguing education finance tool, one that should be explored with optimism and caution: optimism for their potential benefits to quality, affordability, and access, and caution for the risks they pose to students.

In this developmental stage, policymakers, schools, third-party providers, and investors have an opportunity to guide ISAs toward an approach that centers students and broader equity. ISAs need clear regulatory guardrails, and ISA providers should work with policymakers and regulators to put those guardrails in place and aspire to exceed those standards in their own ISA programs.

The relative newness of ISAs should underscore that there is much about ISAs that we do not yet understand. As students graduate from ISA programs and begin to make payments, their experiences should be listened to and taken into account. Extensive field tests are needed to identify optimal disclosure language and format in contracts. More research is needed to determine whether ISAs are actually successful in improving economic opportunity, particularly for frontline workers and workers of color. As more outcome data becomes available, hopefully these questions can be explored with greater clarity.

The need for accessible education and training opportunities is vast, and there is no silver bullet. American workers need a multifaceted approach, including greater public investment in community colleges, workforce development, and direct tuition assistance; as well as employer investment in workers' skills. A broader set of approaches is also necessary to promote greater equity and economic justice. Building robust policy and practice frameworks to ensure ISAs are student-centered could serve as an important complement to this broader agenda.

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