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Risk-Sharing Income Share Agreements: How a New Financing Mechanism Can Protect Taxpayers and Incentivize Universities to Offer Affordable Career-Oriented Programs

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Key Points

- Policymakers need to take a hard look at the incentives the higher education system is designed to produce and consider the big changes needed to drive better outcomes for each set of payers.
- If students borrow responsibly for college and earn a good living after they graduate, their alma maters should benefit too. However, if they make too little to repay what they borrowed, the institutions, not taxpayers, should bear the burden.
- To begin to address these challenges, Congress could make income share agreements provided by each student's institution the primary (or sole) federal financing option available to students.
- Like all income share agreements, students with a risk-sharing income share agreement, or "rISA," would have their education paid for upfront in exchange for repaying an affordable percentage of their income for a predetermined number of months thereafter.

One might be forgiven for thinking that the higher education policy debate boils down to a simple question: Should college be a federal government entitlement, or should the federal government get out of higher education finance entirely? While, in the short term, some debt forgiveness looks like a more plausible proposition than a significant federal pullback does, neither full debt forgiveness paired with totally "free" four-year college nor a full unwinding of the Higher Education Act (HEA) of 1965 are likely. Instead, in a world where taxpayers and students (or their parents) are likely to continue to share the cost burden of college, policymakers need to take a hard look at the incentives the current system is designed to produce and be willing to consider the big changes needed to drive better outcomes for each payer.

Today, institutions of higher education may charge whatever they wish for the education they provide, and the government provides the capital for students' tuition through loans without institutions bearing any meaningful risk if students do not repay. Naturally, this drives up costs and borrowing. On top of tuition and fees, students can

borrow for living expenses, study abroad, and more, which can quickly lead students to rack up more debt than they can afford.[1] This is particularly true if they are pursuing a field that does not pay especially well, which can vary widely both within and across institutions.[2]

Institutions even acknowledge these problems and say they would limit irresponsible borrowing by their students if they could.[3] However, the federal government generally prohibits this to avoid redlining and because many in Congress view federal loans as an entitlement that they do not want an institution to curtail. Giving colleges greater latitude to limit overborrowing would be a good start to decreasing student debt. Allowing them to set limits on borrowing based on each student's program of study would be even better.

Ultimately, however, institutions will not be truly incentivized to control costs and overborrowing until policymakers tie each student's outcomes to those of their institution. If students borrow responsibly and earn a good living after they graduate, their alma maters should benefit too. However, if they make too little to repay what they borrowed, the institutions, not taxpayers, should bear the burden.

Some institutions seeking this student-friendly bargain have offered their students income share agreements (ISAs), an alternative to loans, which require students to pay a percentage of their earnings over a set number of months, instead of principal and interest. Andrew P. Kelly, senior vice president for strategy and policy at the University of North Carolina System Office, has been a leader in developing and championing the modern ISA.[4] Because American higher education is only several years into this project, ISAs are available to few students. However, it may be possible to offer ISAs to all higher education students nationwide and simultaneously use that financing to ensure institutions have "skin in the game."

By making ISAs both the repayment and accountability system, institutional success is tied to student success without a complex, backward-looking, government-directed formula such as the Barack Obama administration's Gainful Employment rule, which the Joe Biden administration recently announced it will seek to resurrect. But the possibilities for ISAs only begin there. Such a system can also incentivize students to pursue academic programs with stronger career outcomes and institutions to offer more such academic programs with the promise of better financial returns for student and institution alike. With incentives changed, one can expect an entire new ecosystem of supportive partners to finance, deliver, and support students across the postsecondary education landscape.

The federal government already provides several repayment options that are tied to a borrower's income, but they share common challenges. Among them are the complexity of choosing the right program and understanding what monthly payments might be.[5] Further, in income-driven repayment plans, loan balances are forgiven by taxpayers after a certain number of payments, and the balance that is forgiven is then taxable (Figure 1).[6] And, of course, whether a student repays in full or repays nothing has nearly zero direct impact on the institution where they studied.[7]

To begin to address these challenges, Congress could make ISAs provided by each student's institution the primary (or sole) federal financing option available to students. Just like with all ISAs, students with a risk-sharing income share agreement (rISA) would have their education paid for upfront in exchange for repaying an affordable percentage of their income for a predetermined number of months thereafter. These payments would be subject to limits and other consumer protections set by Congress, mirroring many of those in the federal loan program. Sen. Todd Young's (R-IN) ISA Student Protection Act provides insights into how to establish basic parameters around ISAs.[8]

While the Treasury would provide upfront capital, the student's college or university would be responsible for repaying principal and interest to the federal government. Anything collected through the ISA from the student above the amount borrowed would be the institution's to keep, but any shortcoming would be the institution's responsibility to reconcile. In other words, the relationship between an institution and the federal government would essentially be a loan agreement, but the relationship between an institution and its students would be an ISA.[9]

Under the plan, institutions would also have the flexibility to vary the types of investment (federal,

Figure 1. Interactions Under rISA Financing

Source: Adapted from a presentation at the 2019 Federal Student Aid Conference.

institutional, private, or charitable) across academic programs and set different repayment terms (i.e., percentage of income owed and the repayment term length) for students depending on their major. For example, students in a top business program might receive more funds from their institution or even attract outside investment capital and receive favorable terms. On the other hand, students enrolled in a midrange art history program with poor future earning potential might see less favorable terms.

Institutions may also set different terms for an undeclared freshman (riskier) versus a senior scheduled to graduate on time (less risky), which could incentivize completion. Institutions would be strictly prohibited, however, from setting rISA terms based on family income or other factors, such as race, that are protected under the Fair Lending Act.

Another positive side effect is rISAs would drive students toward programs with strong labor market value, including high-quality liberal arts programs, which employers still highly value, and away from programs in which students are less successful after graduation.[10] A risk is that rISAs would draw students away from more creative endeavors or careers such as teaching that often pay less.

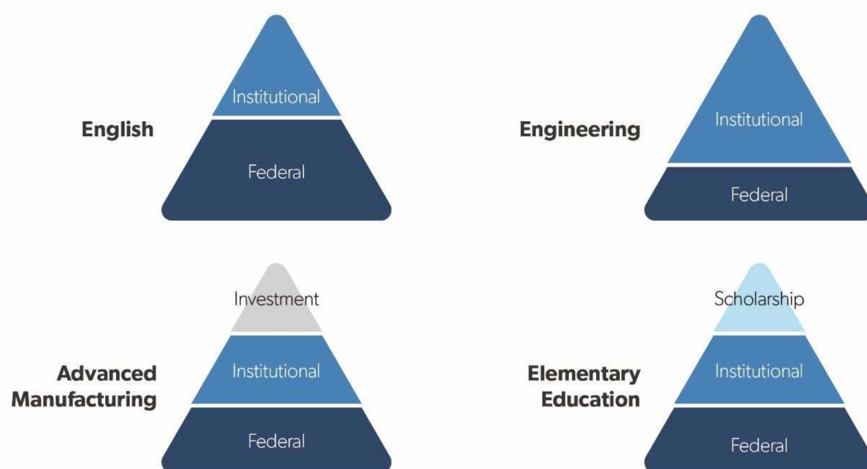
This can be addressed, however, by redeploying need-based scholarships and other aid toward students in these high-value, lower-paying occupations and by reassessing decades of credential inflation that have been enabled by easy access to capital regardless of a student's program. This institution-led approach could have other benefits too. Institutions could finally work with their students to limit overborrowing. They could also make scholarship and tuition discounting go further. Today, a dollar in grant aid is a dollar the institution will not see again. However, by packaging aid into the rISA itself and providing generous terms that expect less than a dollar-for-dollar return, institutions can allow high earners to offset low earners and to maintain support for the arts and other high-value occupations.

In addition, as with existing ISAs, an rISA could accommodate a recent graduate interested in starting a family or performing unpaid public service after graduation more easily than loans could. Contracts could allow repayment terms to be extended a few years—but not indefinitely—if a graduate is out of work, whether by choice or not.

Since established institutions, rather than college students, would be responsible for repaying the federal government, the risk to American taxpayers would be reduced with each new rISA. Institutions might also start funding programs, such as engineering, which are likely to see a larger return, with their own capital, that of investors, or scholarship-granting organizations. As repayments begin to flow and rISA pricing becomes more precise and predictable, institutions may eventually decide that federal strings simply stop being worth it and decline further federal support.

Because the institution can supplement (or offset) federal capital with its own, or that of investors, an rISA could have benefits similar to a postsecondary lifelong learning account. Courses and other services that would not otherwise be eligible for federal aid could be paid for with nonfederal funds but packaged into the same rISA. An English major could enroll in a coding boot camp, or a student in a general studies associate degree program could earn a welding certificate from his or her community college's not-for-credit offerings. Each student would enjoy a more complete educational experience but still make a single, affordable payment tied to his or her income (Figure 2).[11]

Figure 2. Some rISA Design Possibilities



Source: Adapted from a presentation at the 2019 Federal Student Aid Conference.

Some conservatives are reasonably worried that federal endorsement of rISAs will crowd out private ISAs just as federal loans' generous loan subsidies and forgiveness options have crowded out private loans, leaving students with fewer options. What must also be acknowledged, however, is that ISAs are one option that has already been crowded out by federal policies.

Even with significant resources and strong, visionary institutional leadership behind ISAs at places such as Purdue University, the Back a Boiler program is not available to freshman, students without a declared major, or those studying part-time. Instead, the program makes clear that it is designed to replace last-dollar loan programs such as private loans or the federal PLUS program.[12] At other institutions, too, ISAs do not supplant federal direct loans.

Mitch Daniels, president of Purdue, deserves tremendous credit for proving ISAs can work in practice, not just in theory, and for putting institutional funds on the line to do so. Early-stage ISA companies do too. It has taken real bravery and dedication. However, as long as the federal loan programs exist in their current form, ISAs are unlikely to replace most federal financing for most students.

Moreover, today's private ISAs face challenges in accurately assessing borrower earnings and collecting payments. Both functions could be handled through the tax code and paycheck withholding, dramatically simplifying the process for students and reducing overhead and risk for institutions and servicers.[13]

While rISAs would be federally capitalized, they would not be federally run. Institutions would be free to choose servicers and other partners, which they cannot do with federal loans. They would be incentivized to work with those that are best at providing excellent customer service to their alumni. Unlike today, case-by-case exceptions could be made to give a break to students facing hard times. Institutions could also design their own programs to educate students about repayment and have greater leeway to provide disclosures. Today's loan system, by contrast, buries students in a mountain of paperwork and notifications designed by "consumer advocates," which (if they are read at all) rarely serve to educate but frequently intimidate.

Replacing the HEA's maze of loan and repayment programs with ISAs may be difficult in today's Congress, but there is nothing fundamentally new here that Congress has not endorsed before. Sharing risk with institutions was a key component of the popular Perkins Loan Program, and, as mentioned, existing income-based repayment plans have similar components to ISAs.

But it is not altogether clear that Congress would even need to authorize this type of program. In 2019, I worked at the Department of Education, where we developed a pilot proposal that would have allowed institutions to create ISAs (or new types of loans) by agreeing to repay students' federal loans.[14] Using the HEA's Experimental Sites authority, the department would have piloted the idea with a handful of schools by waiving the prohibition on an institution limiting a student's borrowing. The department would also waive an obscure rule that can count an institution's repayment of its students' loans as a default if they are doing so

to “game” the department’s cohort default rate accountability measure.

The proposed experiment was never launched due to the need to quickly shift focus to COVID-19 relief, but an interesting fact eventually became apparent: The waiver to allow institution-set borrowing limits helps students but is not essential to setting up this type of arrangement. The cohort default rate provision is triggered only if institutions “or any other affiliated entity or individual make a payment to prevent a borrower's default on a loan.”[15] It is not triggered, for example, if an institution makes payments on traditional loans to incentivize program completion or working after graduation as a medical professional in a rural area.

So, if neither waiver is necessary, could institutions try this today? The Department of Education has, unfortunately at times, “reinterpreted” the rules after an institution decided to color too far outside the lines. Even so, maybe an institution is brave enough to try. If not, policymakers must work these creative financing options into the HEA.

That may require conservatives to accept ongoing federal support if it holds institutions accountable and protects taxpayers. For progressives, that means accepting a world in which those who benefit from the education pay for some of it but within a framework that provides students with clearer incentives and a less adversarial relationship with their source of financing. Big changes are needed, but significant opportunities remain for policymakers to support students within the existing framework, even if their primary goal remains to have taxpayers cover either all college costs or none.

Ultimately, all parties should be able to support financing arrangements that ensure students can afford their monthly payments; open doors to new, career-aligned educational offerings; and empower institutions to design arrangements that work for their students. These changes alone could revolutionize higher education opportunity in America.

About the Author

Michael Brickman is a national public policy leader who specializes in developing cutting-edge innovations in education reform, skills-based hiring, and the future of work. He advises companies, nonprofits, and investors on the innovations that are changing how we work and learn.

Notes

1. For students in school at least half-time, the cost of attendance includes “the estimate of tuition and fees, cost of room and board (or living expenses), cost of books, supplies, transportation, loan fees, and miscellaneous expenses (including a reasonable amount for the documented cost of a personal computer), allowance for child care or other dependent care, costs related to a disability, and reasonable costs for eligible study-abroad programs.” US Department of Education, “Cost of Attendance (Budget),” in *Federal Students Aid Student Handbook*, 2020, https://fsapartners.ed.gov/knowledge-center/fsa-handbook/2020-2021/vol3/ch2-cost-attendance-budget.
2. US Department of Education, “College Scorecard,” https://collegescorecard.ed.gov/. University of Delaware graduates with a computer and information sciences bachelor’s degree earn $70,176, and those with a neurobiology and neuroscience bachelor’s degree (which presumably is not enough education for an in-field job) earn $15,922. Computer and information sciences bachelor’s degree–holders from the University of Pennsylvania earn $138,932, while those from the University of Puerto Rico–Ponce earn $16,169.
3. National Association of Financial Aid Administrators, “HEA Reauthorization Positions,” https://www.nasfaa.org/hea_positions.
4. Andrew P. Kelly, Miguel Palacios, and Tonio Desorrento, *Investing in Value, Sharing Risk: Financing Higher Education Through Income Share Agreements*, American Enterprise Institute, February 26, 2014, https://www.aei.org/research-products/working-paper/investing-in-value-sharing-risk-financing-higher-education-through-income-share-agreements/.
5. Pew Charitable Trusts, “Borrowers Discuss the Challenges of Student Loan Repayment,” May 20, 2020, https://www.pewtrusts.org/en/research-and-analysis/reports/2020/05/borrowers-discuss-the-challenges-of-student-loan-repayment.
6. The IRS has not weighed in on tax treatment of income share agreements (ISA).

7. Institutions must keep an eye on their cohort default rates, but sanctions based on that measure are extremely rare, especially for public or private nonprofit institutions.

8. ISA Student Protection Act of 2019, S. 2114, 116th Cong., 1st sess., https://www.congress.gov/bill/116th-congress/senate-bill/2114/text.

9. Michael Brickman, "A New Experimental Site: Institutional Investment in Student Success" (presentation, Federal Student Aid Training Conference, virtual, 2019).

10. Hart Research Associates, *Fulfilling the American Dream: Liberal Education and the Future of Work: Selected Findings from Online Surveys of Business Executives and Hiring Managers*, July 2018, https://www.aacu.org/sites/default/files/files/LEAP/2018EmployerResearchReport.pdf.

11. Brickman, "A New Experimental Site."

12. Purdue University, "FAQ About Back a Boiler—ISA Fund," https://www.purdue.edu/backaboiler/FAQ/index.html.

13. Jason D. Delisle, *How to Make Student Debt Affordable and Equitable*, American Enterprise Institute, July 23, 2019, https://www.aei.org/research-products/report/how-to-make-student-debt-affordable-and-equitable/. See Jason Delisle's excellent ISA proposal, which would give all students a $50,000 line of credit repaid through an ISA. He also provided a useful exploration of how such a repayment mechanism might work.

14. Brickman, "A New Experimental Site."

15. 34 CFR § 668.202.

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